IMPLICATIONS OF MACRO-ECONOMIC FACTORS ON FOREIGN DIRECT INVESTMENT FLOWS IN KENYA FOR THE PERIOD OF 2002-2013

BY

GEORGE O. OTIENO

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SUMMER 2015
IMPLICATIONS OF MACRO-ECONOMIC FACTORS ON FOREIGN DIRECT INVESTMENT FLOWS IN KENYA FOR THE PERIOD OF 2002-2013

BY

GEORGE O. OTIENO

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

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SUMMER 2015
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: ________________________

George Otieno (628593)

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
ABSTRACT

Foreign Direct Investments (FDI) plays a significant role in the long-term economic development and prospects of most Developing Countries in Africa. This is mainly through; creation and containing of capital, enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructural base, raising productivity and generation of employment opportunities, and lastly, boosting balance of payment by enhancing exports of commodities. Consequently, macroeconomic factors normally hinge on a number of economic policy variables; monetary, fiscal, financial and commercial policies used to capture the policy environment. Most of these key factors such as; inflation, interest rate, exchange rates and expenditure among others in most Sub-Saharan African countries, are faced on changes over time (Okafor. O. H., 2012). Some of these changes are either predictable or unpredictable but in most cases are uncertain hence pose high risks to investments.

The study therefore examined the effects of the macroeconomic factors, namely; real interest rate, development expenditure (infrastructure), inflation rate, and real exchange rates on the level of foreign direct investment inflows of the country. The period for the study is 12 years spanning from 2002 to 2013, and this was sufficient enough to give a conclusive result.

Also, linear regression model and correlation analysis were used in analyzing the secondary data that had been collected. The research had adopted a descriptive, and non-probability research design and was quantitative in nature. This is because it was used to describe, explain, and validate the findings.

The study then found out that the real interest rate had a negative correlation with the FDI flows into the country. This relationship was also found to be insignificant and hence depicted that changes in the real interest rate have a very minimal effect on FDI flows. The study also found that development expenditure had an insignificant effect on FDI flows that the country receives. But it is positively correlated to the FDI inflows, meaning that with any given change in development expenditure; the FDI inflows will change too in the same direction and at a minimal state. Inflation rates had an insignificant effect on the level of FDI
flows but the relationship was of a negative correlative nature. Hence any change in inflation rates in the country will certainly change the level of FDI inflows but at a minimal rate. Finally, the real exchange rate was also found to be having an insignificant relationship with the foreign direct investment inflows to the country. However, it was negatively correlated to the FDI inflows and thus with any change in the real exchange rates in the country; the level of FDI inflows will certainly be affected, only that the effect will be minimal.

Therefore, in as much as the macroeconomic factors being studied have an insignificant relationship with the level of foreign direct investment flows that the country receives; the effect is still manifest. The effect is also of long term nature, meaning that if the level of infrastructure is not improved now; then in the near future the level of FDI flows will have deteriorated and vice versa. It is then recommended that the government through treasury increase the funds allocated to development expenditure and that the Ministry of Transport and Infrastructure increase absorption rate of the infrastructural projects underway.

It is also recommended that the government should maintain a sound and stun macroeconomic stance so as to regulate the level on inflation; interest rates; and real exchange rates. That is, it should look for ways of increasing its channels of trade overseas so as to increase on the level of exports. This will cushion the country’s currency from other dominant currencies and therefore stabilize the exchange rates hence increasing level of doing business. The effect will also be translated to the inflation rates.

The government should also take consideration of stretching on its revenue collection base so as to finance its budgetary deficit or even borrow from the foreign market more than it should on the domestic market. This will avoid real interest rates from being high and hence affecting the FDI flows to the country. Also, it is recommended that it should regulate the market interest rates, as it has always been; so as to avoid the interest rates be set by the commercial lending institutions.
ACKNOWLEDGEMENT

I thank the Almighty God for giving me the ability and passion to persevere to the completion of this program and project.

I also thank my supervisor Dr. Amos Njuguna, for his patience and persistence in providing me with valuable guidance, direction, availability and help throughout the research.

I would also like to express my sincere gratitude to my parents and siblings for years of support, encouragement and love that they have given me throughout my life both academically and otherwise.

Finally, thanks to the United States International University and the Chandaria School of Business, where I have had the best platform, good learning atmosphere and all the resources I needed to complete my research work.
DEDICATION

I would like to dedicate this work to my father and mother (Mr. & Mrs. Otieno) who have worked so hard in order to make sure that I acquire this quality education.
## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABSTRACT</td>
<td>v</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENT</td>
<td>vi</td>
</tr>
<tr>
<td>DEDICATION</td>
<td>viii</td>
</tr>
<tr>
<td>TABLE OF CONTENTS</td>
<td>ix</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xii</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xiii</td>
</tr>
<tr>
<td>ABBREVIATIONS</td>
<td>xiv</td>
</tr>
<tr>
<td>CHAPTER ONE</td>
<td>1</td>
</tr>
<tr>
<td>1.0 INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>1.1. Background of the Problem</td>
<td>1</td>
</tr>
<tr>
<td>1.2. Statement of the Problem</td>
<td>4</td>
</tr>
<tr>
<td>1.3. General Objective</td>
<td>5</td>
</tr>
<tr>
<td>1.4. Specific Objectives</td>
<td>5</td>
</tr>
<tr>
<td>1.5. Significance of the Study</td>
<td>6</td>
</tr>
<tr>
<td>1.6. Scope of the Study</td>
<td>7</td>
</tr>
<tr>
<td>1.7. Definition of Terms</td>
<td>7</td>
</tr>
<tr>
<td>1.8. Chapter Summary</td>
<td>8</td>
</tr>
<tr>
<td>CHAPTER TWO</td>
<td>9</td>
</tr>
<tr>
<td>2.0 LITERATURE REVIEW</td>
<td>9</td>
</tr>
<tr>
<td>2.1. Introduction</td>
<td>9</td>
</tr>
<tr>
<td>2.2. Effect of the Real Interest Rate on FDI flows</td>
<td>9</td>
</tr>
<tr>
<td>2.3. Effect of Development Expenditure on FDI flows</td>
<td>15</td>
</tr>
<tr>
<td>2.4. Effect of Inflation rates to FDI flows</td>
<td>18</td>
</tr>
<tr>
<td>2.5. Effect of Real Exchange Rates on FDI flows</td>
<td>19</td>
</tr>
</tbody>
</table>
2.6. Chapter Summary

CHAPTER THREE

3.0. RESEARCH METHODOLOGY

3.1. Introduction
3.2. Research Design
3.3. Population and Sampling Design
3.4. Data Collection Methods
3.5. Research Procedures
3.6. Data Analysis Methods
3.7. Chapter Summary

CHAPTER FOUR

4.0. RESULTS AND FINDINGS

4.1. Introduction
4.2. General Trends
4.3. Effect of the Real Interest Rate on FDIs flows
4.4. Effect of Development Expenditure on FDI flows
4.5. Effect of Inflation rates to FDI flows
4.6. Effect of Real Exchange Rates on FDI flows
4.7. Chapter Summary

CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS, AND RECOMMENDATIONS
5.4. Conclusion .......................................................................................................................... 56
5.5. Recommendations ............................................................................................................. 58
REFERENCES ......................................................................................................................... 61
APPENDICES .......................................................................................................................... 70
LIST OF TABLES

Table 1.1; Top 10 African Destination Countries for Infrastructure Projects....................3

Table 4.21; Descriptive data on FDI inflows in Kenya.....................................................33

Table 4.30; Correlation Analysis on FDI inflows and Real Interest Rates in Kenya........39

Table 4.31; Regression Analysis on FDI inflows and Real Interest Rates in Kenya.........40

Table 4.40; Correlation Analysis on FDI inflows and Development Exp in Kenya..........................36

Table 4.41; Regression Analysis on FDI inflows and Development Exp in Kenya........42

Table 4.50; Correlation Analysis on FDI inflows and Inflation Rates in Kenya..............42

Table 4.51; Regression Analysis on FDI inflows and Inflation Rates in Kenya.............43

Table 4.60; Correlation Analysis on FDI inflows and Real Exchange Rates in Kenya..........................44

Table 4.61; Regression Analysis on FDI inflows and Real Exchange Rates in Kenya........45
LIST OF FIGURES

Figure 4.20; Foreign Direct Investment Flows in Kenya........................................33

Figure 4.21; Interest Rate Trends in Kenya.........................................................35

Figure 4.22; Inflation Rates in Kenya.................................................................36

Figure 4.23; Kenya Shilling against other Major Currencies............................38
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>BoP</td>
<td>Balance of Payment</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>CBR</td>
<td>Central Bank Rates</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investments</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<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>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
</tbody>
</table>
CHAPTER ONE

1.0 INTRODUCTION

1.1. Background of the Problem
On a global basis, Foreign Direct Investment (FDI) flows increased by about 35 percent to $345 billion between the second and third quarter of 2013 after a decrease of 32 percent between the first and second quarter of the same period. Despite this increment in the third quarter, total flows for the first three quarters of 2013, at $977 billion, were 4 percent below the $1 trillion observed over the same period in 2012. This sluggish performance would seem to owe to a number of sources of uncertainty that are discouraging FDIs from investing; including the euro-zone crisis, slowed growth in transition economies such as China, and fears regarding the financial stability of emerging markets in general, resulting in the recent sell-off in emerging market currencies (OECD., 2014).

The flows then declined by 8 percent in 2014 to around $1.26 trillion down from an estimated $1.36 trillion in 2013. This was also because of a strong influence of economic uncertainty and geopolitical risks such as increased regional conflicts (UNCTAD, 2015).

In Africa, FDI inflows fell by about 3 percent to an estimated $55 billion, which was largely due to a significant decrease of FDI into North Africa. Inflows in North Africa declined by about 17 percent to around $12.5 billion due to continued civil unrest in countries such as Libya; hence slowing down the region’s potentiality as an FDI destination. Other sub-regions experienced similar inflows in 2013. FDI inflows in the continent was largely contributed by increased inflows to Mozambique accelerated by its potential as a one of the world’s largest liquefied natural gas exporter (UNCTAD, 2015).

In Sub-Saharan Africa, FDI inflows still remained flat with minimal FDI activities taking place. For instance in Nigeria, mergers and acquisitions, as part of FDI; grew to $1.3 billion. This was experienced in consumer-oriented sectors, which then helped counterbalance the decline in FDI into other sectors; hence maintaining at a level of about $4.9 billion (UNCTAD, 2015).

As of East Africa, it attracted an estimated $ 6.6 billion in 2012, above the $5.6 billion peak in 2006. With recent resource discoveries in Tanzania, Uganda and Kenya; FDI is expected to
increase overtime. The expansion of household purchasing power, improved infrastructure and regional integration may trigger further investment in Kenya. Progress made by the government to improve its partnerships with the private sector and foreign institutions such as; United States-East African Community Trade and Investment Partnership in 2012, in particular in Kenya’s banking and booming telecommunications sectors; were likely indicators towards increased FDI flows in the next years to come (African Development Bank Group., 2014.).

Furthermore, the Kenyan government has over the past few years implemented sound macroeconomic policies, resulting to massive macroeconomic fundamentals. A prudent fiscal stance has kept the country’s budget deficit at an average of 4.9 percent of GDP during the last 5 years, even though it performed below its East African neighbors. The budget deficit is forecasted to narrow down to below 4 percent in the short term, mainly because of continued fiscal discipline and increased revenue collection from taxation as well as rationalization of recurrent expenditure. The country’s tax to GDP ratio, estimated at 20.1 percent during 2013/14 period, remains high by regional standings, compared to Uganda’s 13 percent and that of Tanzania at 18 percent (African Development Bank Group., 2014.).

In 2013 to date, the Central Bank of Kenya has continued to maintain an expansionary monetary policy stance. It eased its monetary policy stance since mid-2012, reducing the Central Bank Rate (CBR) from 18 percent to the current rate of 8.5 percent. This then means that it is trying to moderate the real interest rates prevailing in the market so as to improve and increase access to capital for private-local and foreign investments (African Development Bank Group., 2014.).

Also, in the last report on Debt Sustainability Analysis done in 2013, World Bank and IMF; state that the country is facing low risk of external debt distress. All external debt indicators remain well below the debt burden thresholds. However, IMF recommended the government to pursue sound macroeconomic policies aimed at reducing the country’s vulnerability to external shocks and public debt-to-GDP ratio further. This prompted the country to start sourcing out for debt internationally, by raising over USD 2 billion on a sovereign bond in the first quarter of FY 2013/14; to avoid crowding out the foreign direct investment and improve access to capital for investment (African Development Bank Group., 2014.).
Moreover, infrastructure gaps, particularly regarding electricity and logistics, are persistently cited as the biggest challenges by those doing business in Kenya and the entire African continent. At a macro level, Kenya and the continent at large, in terms of economic growth, is inherently constrained until the infrastructure deficit is bridged. Ironically, strong economic growth has been occurring despite the infrastructure constraints but this challenge is in the progress of being addressed with the country having almost 60 projects related to infrastructure being undertaken, using an estimate of $32,085.15 million (Table 1.1).

Table 1.1; Top 10 African Destination Countries for Infrastructure Projects

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of projects</th>
<th>Sum of capital invested (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>134</td>
<td>129,934.0</td>
</tr>
<tr>
<td>Nigeria</td>
<td>106</td>
<td>95,480.5</td>
</tr>
<tr>
<td>Egypt</td>
<td>82</td>
<td>60,164.7</td>
</tr>
<tr>
<td>Uganda</td>
<td>63</td>
<td>17,730.3</td>
</tr>
<tr>
<td><strong>Kenya</strong></td>
<td><strong>60</strong></td>
<td><strong>32,851.5</strong></td>
</tr>
<tr>
<td>Algeria</td>
<td>34</td>
<td>87,154.1</td>
</tr>
<tr>
<td>Mozambique</td>
<td>31</td>
<td>32,085.0</td>
</tr>
<tr>
<td>Libya</td>
<td>29</td>
<td>20,668.4</td>
</tr>
<tr>
<td>Tanzania</td>
<td>29</td>
<td>16,185.1</td>
</tr>
<tr>
<td>Cameroon</td>
<td>25</td>
<td>8,470.8</td>
</tr>
</tbody>
</table>

*Source:* (Ernst and Young., 2013).

Even with economic and institutional reforms in most African countries during the past few years, FDI flows to the region still continues to be very minimal and uneven. Onyeiwu and Shrestha (2004), who used fixed and random effects models to explore whether the stylized determinants of FDI affect the flows to the continent over a period of about 25 years (1975 to 1999); found out that economic growth, inflation, international reserves, and natural resource availability, are very significant to FDI flows to Africa.

Therefore, as FDI flows in the continent and the in country are projected to grow due to intensive economic and institutional reforms; macroeconomic factors such as the level of infrastructure, exchange rates, interest rates as well as inflation rates still remain a major challenge.
1.2. Statement of the Problem

Lots of studies have been done regarding macroeconomic policy and foreign direct investments in a certain economy or rather a given group of economies in the globe. A lot more has been done on foreign direct investment and their impact towards the society, and as early as 1960s, economists such as Vermon had already started recognizing the importance of location as a determinant of FDI decision making process on a global scale. Their findings were varied depending on various regions of the world. But as the world started being a global village rapidly, then interests on the aspect of FDI determinants and there flows was renewed. Sub-Saharan Africa (SSA) draw immense interest given that many foreign investors perceived it as a good investment location, largely because of its natural resources.

In fact, by early 70s, SSA had attracted a bigger share of FDI flows than Asia and North America, however by 2000, the share started declining at a higher margin (Cleeve. E., 2008). This caused majority of the SSA countries to revert to various mechanisms of enticing FDIs back to their countries once more. Among the mechanisms used, key to the study, was macroeconomic policy framework.

A study done on “Impact of Macroeconomic Factors on Foreign Direct Investment in Ghana” by (Havi. K. D. E. and Attah-Obeng. P., 2013), focusing on Ghana alone had its main objective based on macroeconomic determinants of foreign direct investment for a period of 1980 through to 2012. The study highlighted the main macroeconomic factors that affected the FDI flow in Ghana and this has made it much similar to the study to be conducted, only that it focused on a country with somewhat different unique characteristics than Kenya that was studied.

Furthermore, according to Ezeoha. E. A. and Cattaneo. N., (2011) empirical evidence that are supposed to have been used in guiding for policies that can help increase FDI inflows in Africa is still very limited. A lot of the available findings are not yet extensive on the macroeconomic variables affecting FDI inflows into Africa. Even so, previous studies have revealed that macroeconomic factors have specific effects on FDI inflows to developing, transitioning, and developed economies respectively (Busse. M. et al., 2006). Asiedu. E., (2002.); also strongly concurs with this sentiment when his findings revealed that the effects
of macroeconomic variables on FDI inflows in other developing regions do not necessarily match with that of Sub-Saharan Africa countries.

These peculiarities indicate the need to account for the prevailing macroeconomic policies in most African countries with regards to their ability to attract more FDI inflows. This actually forms one of the basis to which the study was conducted. In fact, (Asiedu. E., 2006.); affirms to this when he found out in one of his research works that macroeconomic instability, investment restrictions, political instability and corruption have adversely affected FDI to Africa.

Finally, a limited number of studies have been conducted in the country with regards to the macroeconomic policy and how it affects economic conditions of the country, the most recent being done and published by (Mutuku. C. and Koech. E., 2014). They actually focused on the monetary and fiscal 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 a 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. This then forms part of my study in the next chapters to follow.

1.3. General Objective
The main objective of this study was to determine to the influence that macroeconomic variables have on FDI flows.

1.4. Specific Objectives
The specific objectives were;

1.4.1 To determine the extent to which real interest rates influences FDI flows in the economy of the country;

1.4.2 To determine the extent to which public expenditure influences FDI flows in the country;

1.4.3 To assess how inflation rates influence FDI flows in the country’s economy;

1.4.4 To determine how exchange rates influence FDI flows in the country.
1.5. Significance of the Study

The study is deemed to be significant in the following areas;

1.5.1 Treasury and Finance

The study will help the government, especially Treasury, in formulation of economic policies, in particular, fiscal policy; that is aimed at encouraging the existence and sustenance of foreign direct investors in the country. It will enable them to improve on such areas as openness to doing business and thereby placing the country at that position of being an attractive destination of investment. The study will also help them implement fiscal incentives that yield more benefits than costs and hence encourage economic growth.

1.5.2 Monetary Policy

Also, this study will help the monetary policy committee of the Central Bank of the country in formulating control policies that govern the exchange rates in a manner that will encourage for economic growth and the home currency appreciating. This will strengthen the local currency and thereby encourage for more foreign investments.

1.5.3 Budgetary Committee

Furthermore, it will guide the budgetary formulation committee of the government in apportioning budgeted funds towards key developmental areas that may help spur the economy. These key areas may be on infrastructure among others, which should have a higher rate of investment to the economy so as to limit of debt levels and enable for economic growth.

1.5.4 Central Bank Rates (CBR)

The study is also aimed at assisting the Central Bank of the country in knowing the significance of the levels of lending rates by the commercial banks towards both foreign and local investments. With this information, CBK will be in a position of taming the lending rates through CBR.
1.6. Scope of the Study
The study will focus on the macroeconomic policy and foreign direct investment net inflows, in the country for the period of 2002 to 2013. The 12 year period is comprehensive enough to provide a ground for conducting an exhaustive research.

1.7 Definition of Terms

1.7.1 Foreign Direct Investment (FDI); A purchase of physical assets, such as plant and equipment, in a foreign country, to be managed by the parent corporation (Eitenman. D. K. et al., 2007).

1.7.2 Macro-economic uncertainty; Operating exposure’s sensitivity to key macro-economic variables, such as exchange rates, interest rates, and inflation rates (Eitenman. D. K. et al., 2007).

1.7.3 Open market operations (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).

1.7.4 Non-performing loans; loans whose payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons such as a debtor filing for bankruptcy to doubt that payments will be made in full (IMF., 2005).

1.7.5 Balance of payments (BoP); They are accounts that record the payments and receipts of the residents of the country in their transactions with residents of other countries (IMF., 2005).
1.8. Chapter Summary
This chapter therefore has touched on the background of the study being conducted, that is; macroeconomic factors and the state of foreign direct investments in the country. It has laid out the key objectives too and stated justifications as to why the study was to be conducted. The next chapter will be the literature review, which will entail theoretical analysis of the specific objectives; followed by the methodology of collecting data and analyzing them; then the fourth chapter will be presenting the results and findings of the data collected; and finally the last chapter will focus on discussions then conclude with further recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1. Introduction

This chapter has addressed a hypothetical, detailed analysis on macroeconomic variable implications on FDIs in the country. It has analyzed various findings and conclusions on other research done in the previous years on the effects of real interest rates, public expenditure, inflation rates, and real exchange rates on the level of foreign direct investment inflows in the country. The findings are more of theoretical and hence empirical in nature.

2.2. Effect of the Real Interest Rate on FDI flows

Interest rates always play a crucial role in macroeconomic policies of various governments. This therefore, has an implication on the monetary policy of the country. The great challenge on this part is that most central banks have been constrained in their ability to set interest rates by international capital flows, which then includes foreign direct investment flows. As for African countries, it gets worse since their financial markets are characterized by high level of information asymmetry and their central banks are not perceived by markets as having credibility, in terms of governance and political interference (Olweny. T., 2011).

In addition, the interest rate in Sub-Saharan Africa (SSA), a measure of the cost of borrowing on capital funds and a major factor of macro-economic component, has always been the highest in developing countries. In developed economies like the US, UK, and Japan; the rates have always been low in order to stimulate economic activity (Afful. K. B. and Asiedu. K. F., 2014).

Furthermore, in Kenya; movements in short-term interest rates are usually made sure that they are in line with the CBR while the Open Market Operations (OMO) were sustained in order to support liquidity management in the financial market. Commercial bank’s lending rates declined from an annual average of about 19.73 percent in 2012, to 17.31 percent in 2013, and around 16.51 percent in 2014; which is in consistent with the monetary policy stance. But then there remains space for further reductions in lending rates by commercial...
banks and raise the deposit rates in order to incentivize the mobilization of capital funds for investment (African Development Bank Group., 2014.).

The Central Bank of Kenya (CBK) has in most cases pursued a prudent monetary policy, which has always helped to contain inflation rates and interest rates in the country. CBK has eased its monetary stance since mid-2012, reducing the central bank rate (CBR) from 18 percent to the prevailing 8.5 percent. This has generally led to relative stability of domestic commodity prices, the real exchange rate, and the level of interest rates over the past few years. This of course had a significant effect on the supply side of the economy of the country and is expected to spill over to the fiscal years to come, hence sustaining low interest rates.

Interest rate margins are of significant importance to any given economy because it largely determines investment activities. According to Wei and Liu (2001), in a study on economic linkages between FDI and the cost of borrowing; stated that, if the cost of borrowing in the home country is lower than the host country, the home country firms have a cost advantage over their rivals or subsidiaries in the host country, and are thereby in a better state of entering the host economy as foreign direct investors. However, the higher the cost of borrowing of foreign investors in the host economy relative to their respective home economies, the higher will be the ability of foreign firms to compete with domestic firms in the host countries as they are have the ease of access to capital funding; thus resulting to a possible increase in inflows in FDI-receiving country.

The fact that lower interest rates in the home country encourages the investor to prospect into foreign investment operations through foreign direct investment in the recipient countries, is based on the assumption that they will raise the needed funds for investment in the home country, and use it to finance their activities in the host country. Moreover, this may be a true case if the investment projects are wholly owned by foreign investors, but it may not be the case when they are jointly owned by a local and foreign partners as the former have to partially contribute funds in accordance with the percentage share on equity (Wei.Y and Liu. X., 2001). Majeed and Ahmad, 2008 also concurs with the above findings; they actually found out that if the cost of borrowing is higher in the host country, foreign entities can enjoy cost advantage over local domestic firms and thus, are in a better position of entering the host country market by funding their investments from home country. In contrast, if the foreign
investors use funds sourced in the host country, this would reduce their cost advantage benefits.

Also, since these foreign firms who move across borders tend to be large, in terms of worth; they may still enjoy a cost advantage over local firms if they desire to borrow from the host country market. This is because the cost of borrowing would be cheaper for them relative to local firms due to their perceived risk (Mengistu. A. and Adhikary. B. K., 2011). Most countries especially in the developing world normally insist on partial ownership in foreign firms by the locals. The percentage of partial ownership depends on different countries economic orientation and at some point it goes down to different industries. Therefore, factors affecting FDI inflows held constant; the lower the interest rate in the home country relative to that of the host country, the higher the FDI flows into the host economy.

Oladipo (2013), also supports the notion that an increase in lending interest rates determines FDI inflow positively. After an extensive research on Nigeria, he found out that when lending interest rate increases in Nigeria, domestic investors find it very difficult to invest in the country since income level is marginalized as a result of inability to secure funding from loans. This then gives the foreign investors the opportunity of moving capital from home country in order to maximize rate of returns. However, this has a great adverse effect on the economy.

Other scholars such as, Love. J. H. and Lage-Hidalgo. F., (2000) concurred with this notion but the likes of Onyeiwu and Shrestha (2004); Bevan. A. A. and Estrin. S., (2004), had a different outlook on the above analysis, especially on FDI inflows to Africa and transition economies.

But what normally cause interest rates to go up and sometimes decrease? It is, in most cases, budget deficit of a given country.

2.2.1 Inter-link between Public Debt; Interest Rates; and Crowding Effect on FDIs

The public debt accrued by a given country is normally a factor of budget formulation, hence when the size of the budget deficit increases, the government will have to borrow more funds to finance its deficit. The higher level of government borrowings will increase the demand for funds in the loanable funds market and place upward pressure on interest rates. A higher
interest rate will increase the opportunity cost of investment projects for many investors. FDIs already existing in the host country, will postpone spending on plant expansions, heavy equipment, and capital improvements. Thus, the higher interest rates caused by the larger deficit will retard private spending as of FDIs. This reduction in private sector spending will at least partially offset additional spending emanating from the deficit. This phenomenon, whereby increased government expenditure financed by increased borrowing leads to a reduction in private sector investment, is referred to as crowding out effect. Hence, the crowding-out effect implies that expansionary fiscal policy will have little, if any, effect on demand, GDP, and employment (Stroup et al, 2006).

Furthermore, as interest rates rise, the exchange rate is likely to rise because international capital flows are attracted by high interest rates. A rise in the value of the currency can be expected to damage firm's competitiveness leading to a reduction in home sales, in favor of cheaper imports; and exports. This in turn may be expected to cause further cut-backs in investment expenditure as well as employment (Baumol. W. J. and Blinder. S. A., 2009). Also, as FDIs are crowded-out by the higher interest rates, the output of capital goods will decline. As a result, the future stock of capital available to future workforce will be smaller than it would have been otherwise. Simply, deficits will have an adverse effect on capital formation and tend to retard the growth of productivity and income (Stroup. L. R. et al., 2006).

The implications of the crowding-out analysis are symmetrical. That is, restrictive fiscal policy will crowd-in FDI spending. If the government increases taxes and/or reduces its spending, the budget will tend to shift towards a surplus/or smaller deficit. As a result, the government’s demand for loanable funds will decrease, placing downward pressure on the real interest rate hence encouraging for sourcing out for credit locally for FDIs (Stroup. L. R. et al., 2006).

Some researchers have come to conclude, after conducting their research in developed countries such as the US; that budget deficits do create some crowding out effect of private investment, especially FDI. In particular, it appears that taxes crowd out investment and output, but only for a short-term period. However, while budget deficits and taxes cause crowding out, the national debt has little impact on foreign direct investment and GDP, and
government expenditure appears to create a crowding in effect, supporting the Keynesian multiplier effect (Snyder. T. C., 2011).

Also, it is coming out evident that government borrowing from public and foreign capital markets is not the sole reason behind crowding out FDI from access to capital. Capital demand stemming from the private sector and FDI projects is indeed likely to decrease with a slowdown in economic activity. Financial institutions themselves will remain cautious with regards to extending further credit to the FDI within the context of a drive to maintain their books of account as liquid as possible (Fayed. M. E., 2012).

Much as government can crowd in and out FDIs in the economy; FDIs too can influence the effect crowding in and out domestic investments. That is, by creating spillover effects; through the diffusion of new technologies and forward or backward production linkages; FDI may lead to new or higher amounts of domestic investment where it would not be possible in the absence of FDI, hence creating a crowding in effect. However, due to the loss of competitiveness of the domestic investments, increase in the level of interest rates or adverse knowledge spill over, FDI carries a risk of crowding out for domestic investment (Acar. S. Eris. B. and Tekce. M., 2003). The extent of the crowding out will largely depend on the extent to which interest rates rise and the extent to which FDI spending, especially investment, is dampened by the higher interest rates (Baumol. W. J. and Blinder. S. A., 2009).

Therefore, as the global capital markets become more and more integrated and as the growth of FDIs that can tap various national capital markets continues, the relevance of crowding out is likely to diminish. It is unlikely that one government's borrowing, even when large, will have a significant impact upon the availability of global capital funds for FDI expenditure (Nellis. J. G. and Parker. D., 2004).

Furthermore, in times of economic slack, a counterforce arises that is called the crowding-in effect. Crowding -in occurs when government spending, by raising real GDP, induces increase in private investment spending. Deficit spending presumably quickens the pace of economic activity and that is its major purpose. As the economy expands, businesses find it more profitable to add to their capacity in order to meet the greater consumer demands. The strength of the crowding-in effect depends on how much additional real GDP is stimulated by government spending and on how sensitive investment spending is to the improved business
opportunities that accompany rapid growth. It is even conceivable that the crowding-in effect could dominate the crowding-out effect in the short-run, so that investments rises, on balance, when government spending rises (Nellis. J. G. and Parker. D., 2004).

Certainly, if the government borrows more and the total volume of private saving is fixed, then private industry must borrow less. However, if government deficits succeed in raising output, we will have more income and therefore savings. Crowding out stems from the increases in interest rates caused by deficits, whereas crowding-in derives from the faster real economic growth that deficits sometimes produce. In the short-run, the crowding-in effect, which results from outward shift of the aggregate demand curve, is often the more powerful, especially when the economy is at less than full employment (Baumol. W. J. and Blinder. S. A., 2009).

2.2.2 Effects of Fiscal Policy on Interest Rates and FDI flows

Fiscal policy may be used as an intervention policy to influence interest rates in a country. A significant increase in fiscal expenditure implies that the government is in competition with the private sector for borrowed funds in the domestic financial markets. This then widens the interest rate spread, thereby crowding out the private investments and hence FDIs. Also, a very high tax rate restricts consumer spending and investment expenditure and thus domestic demand for debt financing will decrease. However, such interactions are significantly low in SSA countries and thus they have little or no effect on the interest rate margins (Afful. K. B. and Asiedu. K. F., 2014).

In addition, fiscal policy needs to be in such a fine shape, balanced, and implemented in a more discipline manner. This therefore, will enable it to nurture rapid growth in the country’s economy through provision of good infrastructure, human capital, and enable for availability of capital for both foreign and local investments (Krumm. K. Kiringai. J. and Denizer. C., 2010). Furthermore, fiscal space is also of much importance if the various expenditure projects are to be met without affecting the macroeconomic stability or rather raising doubts about the country’s capital status. If growth proves less than anticipated, then the needed fiscal space may prove inadequate to finance the required government budget deficits. Under these circumstances, the government’s attempt to look for funds in the public and foreign capital markets may compromise its economic liquidity and at some point crowd-out its
private sector (Thugge. K. Heller. P. S. and Kiringai. J., 2011). This will then undermine the existence of foreign direct investment flows in the country as they will be subjected to high costs of operation in terms of sourcing out capital.

2.3. Effect of Development Expenditure on FDI flows
With the onset of structural adjustment programs (SAPs) relayed by the IMF and the World Bank to many developing countries, this caused a major debate in the field of fiscal policy. SAPs often relied heavily on public investment, and aimed at improving the current government cash flow position but at the expense of future economic growth (Ley. E., 2009).

Then another factor that stemmed in is the efficiency of government expenditure, which is a key determinant to government size.

Even with the government’s total revenue projections being pegged at 18 percentage nominal growth, to about Kshs.1,212.9 billion from Kshs.1,027.2 billion in 2013/14 fiscal year, overall spending on the other hand is estimated too to nominally increase by 8 percent, from Kshs.1.64 trillion in 2013/14 to Kshs.1.77 trillion in 2014/15 fiscal year.

To meet the country’s fiscal policy stance of building a strong revenue base and containing growth of expenditure, the government needs to deal with the question of improving efficiency in public spending by undertaking cautious austerity measures targeted at containing inflationary pricing and high interest rates among others, in order to allow for the existence and attractiveness of more FDIs in the country (Rono. K. B. et al., 2014).

2.3.1 Effect of development expenditure on Infrastructure towards FDI flows

The major proportion that government normally sets for developmental expenditure would in most cases be channeled towards expenditure on economic affairs such as, agri-business (Commercial Agriculture), Mining, Education, Health, and housing among others. All these expenditures are a proportion of the total outlay of the government and they normally lead to creation of physical or financial assets and enhance human capital development. They, therefore directly impact on the FDI flows in the country (Bhasin. N., 2013).

Research works based on the role of infrastructure in FDI in the African continent has been very scarce and amongst them features Asiedu (2002) who did an intensive analysis over the period of 1980-2000. With the use of number of telephones per 1000 population to measure infrastructural development and controlling for major FDI determinants, she concluded that
African countries that improved their infrastructure received a large number of FDI flows (Khadaroo. A. J. and Seetanah. B., 2008).

Also, research done in Nigeria found that in order to attract and retain FDI in the country, the government should be in a position of improving the standard of infrastructure and provide relevant social amenities, and provide helps in liberalization of regulated services which provide opportunities for private investment and management (Izuchukwu. O. O. et al., 2014). Moreover, studies on developing countries in Africa suggest that investments by governments in providing efficient physical infrastructural facilities improve the investment climate for FDI by subsidizing the expenses on total investment by those investors and thereby increasing their rates of return on investments. Multinationals may be very particular to infrastructure availability for locating their investments in host countries. Poor public investments in a number of developing countries in Africa may be the main focus of structural adjustment programs (SAPs) in order to help channel funds to these sectors and help attract FDIs in those countries (Bissoon. O., 2011).

Furthermore, very few scholars have actually appreciated the significance of infrastructure in stimulating FDI and the few are Sekkat et al (2004), Morisset (2000), and Asiedu (2002). The above authors have argued that the best infrastructure is a necessary condition for foreign investors to operate successfully. Poor infrastructure or just lack public inputs with regards to government expenditure, increases cost of operation for both public and foreign firms. Infrastructure as part government expenditure contributes to the cost structure of any given company and is normally factored in by multinationals as decision support factor in host countries. It is thus considered to improve the investment climate for FDI by subsidizing the cost of total investment by foreign investors indirectly (Khadaroo. A. J. and Seetanah. B., 2010). A good location with the best infrastructure is more attractive than the other determinants (Wei et al., 2000).

Poor infrastructure causes increase in transactional costs and limits access to both local and international markets which ultimately discourages foreign direct investment in developing countries. A greater efficiency can always be achieved in extending infrastructure facilities by considering commercial principle and shifting costs for repositioning of infrastructural facilities through management of contracts or leases like build-operate-transfer (BOT), build
down-operate (BOO) or rather full privatization. Privatization has come up with very useful source of attracting inward FDI (Mlambo. K., 2006).

In addition, Musila and Sigue (2006) and Dupasquier and Osakwe (2006); found out that FDI in Africa are dependent on the infrastructural development of the country. Anyanwu and Erhijakpor (2004), further simplifies this by stating that telecommunications infrastructures economic growth, openness to trade; can significantly increase FDI inflows in Africa. Gholami et al (2006) uses data sample of 23 developing and developed countries over a certain period of time and based on ICT data availability. He further shows that in developed countries, existing ICT infrastructure attracts FDI flows; that is, a higher level of ICT investment leads to a higher level of FDI inflows but in developing countries, the direction of causality goes instead from FDI to ICT.

This sector has recorded mixed results in the last five years and in the country. Contribution of the transportation and communication sector to GDP growth was between 9.9 percent and 9.1 percent in the period 2009 and 2013, while the contribution of the construction sector was 4.1 and 4.4 percent respectively over the same period. However, performance of electricity and water supply was on average less than 2 percent during the same period (KNBS., 2014). A research paper investigating the role of transport infrastructure in enhancing FDI attractiveness, done over the period of 1984 to 2002 and sampling based on SSA countries; the results show that transportation capital has been an important factor in making the countries attractive to foreign direct investors both in the short and long run (Khadaroo. A. J. and Seetanah. B., 2010).

However, some researchers also argue that, excessive government expenditure has a negative impact on foreign direct investment level. They explained that governance was more significant and that improved political governance does not necessarily subject governments to make large investments in their respective economies (Bissoon. O., 2011).

According to Kariuki (2015), not all studies have found out that infrastructural development is a significant variable in attracting and sustain FDI flows in Africa. She argues that after examining about 29 countries in Africa, it was found that infrastructural development was insignificant in influencing FDI flows. Studies found out that poor infrastructure may not deter foreign investors because certain factors like natural resource endowment, openness to
trade, and other macroeconomic variables may have more significant effects. Asiedu (2002) affirms to this argument by conducting a research and finding out that the level of infrastructural development in Sub-Saharan countries was not significant in influencing FDI inflows into Africa. Results from a study conducted by Osili and Nnadozie (2004), which focused on US FDI flows to Africa; also contributed to this argument by stating that there is less robust evidence on the role of infrastructural development on FDI.

2.4. Effect of Inflation rates to FDI flows

High inflation rates normally suggest macroeconomic instability and hence a potential risk for foreign investors in a given country. Empirical analysis done by Wadhwa and Reddy (2011); Udoh and Egwaikhide (2008) all showed inflation rates as having a negative relationship with FDI. In essence, inflation rates drives down level of FDI. Inflation is proxied by the Consumer Price Index (CPI) and this variable is an indicator of the cost of doing business in an economy.

Most Central Banks for most Sub-Saharan African countries have found themselves at very tough moments. In the first half of the 21st Century, SSA countries did well in curbing inflationary pressures, by reducing average inflation rates in the region from 15 percent in 2000 to 6 percent in 2006. However, in the most recent years, SSA region has been hit by huge external shocks; starting from fuel and food crisis of 2007 to 2008, spillovers from the global financial crises in 2008 to 2009, and large increase in commodity prices. This shocks have resulted to negative fluctuations of the inflation rates in the region. Also, other factors such as structural changes that enhance the role of market signals, increasing instability in demand for money, and greater exposure to international capital flows; have played a significant role in the high inflation rates in the region.

Moreover, according to Arbatli (2011); the estimates according to his study suggested that high inflation has a negative impact on FDI flows, but it was not statistically significant at conventional levels in emerging economies as of developing African economies. He further states that the choice of the inflation threshold is somewhat arbitrary and is meant to capture whether having single digit inflation rate has any effects on FDI and also accounts for the conjecture that inflation has non-linear effects on FDI flows to a country.
Further on, Asiedu (2002), Yartey and Adjasi (2007); found out in their studies that inflation rate has a negative effect on the FDI inflows of a country. That is, foreign and domestic investors will be unwilling to invest in an economy of high inflation rate. As found out by Onyiewu and Shrestha (2004); the rate of inflation, in most cases, signals poor economic management. Sayek (2009); has also found out that increased domestic inflation rates normally increases foreign investment through changes in the international consumption trend of the host country; this may reduce the cost of FDI operations.

However, some researchers came to find out that the concept of inflation targeting allows for creating a sound and more stable macroeconomic environment, more especially among developing countries. Inflation targeting is a pull factor in terms of providing a conducive environment for both foreign and local investments (Lin and Ye, 2009; Mishkin, 2007; Batini and Laxton, 2007).

High inflation rate can be a cost of conducting business as foreign investors may enter into long-term contracts in the host country. When the real inflation rate turns out to be very different from the projected inflation rate, foreign investors may lose out as their level of purchasing power tends to reduce. A high inflation rate is then found out to have a negative effect on attracting FDI inflows and sustaining them (Hailu. Z., 2010). Twimukye (2006), also finds out that inflation rate has a negative relationship with FDI flows into Africa. Findings from Asiedu (2006) also show that low inflation rates have a positive effect on FDI flows in Sub-Saharan Africa. Onyeiwu and Shrestha (2004), and Naudé (2007); also found out that; inflation is a significant variable that influences foreign investor who prospect to invest in Africa. Nonnemberg and Mendonça (2004); have shown that FDI is correlated to the level of inflation in developing countries. A lower level of inflation is likely to encourage more FDI inflows as it indicates that an economy has stringent macroeconomic policies and therefore conducive for doing business.

2.5. Effect of Real Exchange Rates on FDI flows

It is quite clear that in most countries, especially developing countries, foreign direct investment (FDI) is a significant source of economic growth and development. FDI promotes growth in labor income and facilitates capital accumulation. In addition, FDI flows are considered as a more favorable type of capital flow as compared to portfolio investments this is because they are more stable than financial investment flows during currency crises
situation (Lipsey. R. E., 2001). Currency crises are normally tagged to exchange rate instability in the international financial markets.

Furthermore, the exchange rate between countries is normally used by investors to measure the cost of production requirements or rather inputs, incurred during the value addition or production processes. Halicioglu (2001), stated that an appreciation of the home country’s currency should by that extent increase the FDI flows as it becomes cheaper to source out for human resources, and other factors of production; with the value of home currency being constant. Conversely, the amount of FDI is deterred when the host country’s exchange rate appreciates.

Also, exchange rate fluctuations and volatility can pose complicated investment scenes to foreign investors by making unpredictable and uncertain the absolute and relative profitability in the investment environment, as well as making uncertain the cost of new capital goods with high import content. The high degree of exchange rate risk during the few years has not only affected foreign investors’ decisions as to where to produce but also impacted on their net income (Chowdhury. A. R. and Wheeler. M., 2008). Pan (2003), also states that the exchange rate affects FDI in two major different ways. First, the appreciation of home country’s currency against the host country’s currency translates into an evident increase in investment value only if the worth of the investment is denominated in the host country’s currency.

Observed the perspective of home country’s investors’ angle, investment in the host country becomes cheaper, which then results into possible increase in net income and thus a higher rate of return to the foreign subsidiary. With higher rates of return then definitely the rate of investment also increases which consequently encourages more FDI inflows in the host country. Wealth of a foreign firm denominated in the host country’s currency also increases as result of depreciation of host country currency depreciates as the production inputs now become cheaper and affordable for foreign firms whose investments are based in their home country currency. This gives them the advantage of acquiring more host country’s assets and hence resulting to an increase in FDI (Cuyvers et al, 2008).

Second, with the appreciation of home country’s currency, the price of home country products become relatively higher. This makes exports from the home country to the host country less competitive and therefore encourages home country firms to relocate their
production process to the host country. This results in increase in FDI inflows to the host country (Pan, 2003). Therefore, a lot more studies have exhibited the negative relationship that co-exists between exchange rate and inward FDI. But quite a number of other researchers works results to opposite conclusions of the above findings.

Kiyota and Urata (2004) examined the impact of exchange rate on Japan’s FDI flows and came to a conclusion that the depreciation of the host country’s currency attracts foreign direct investments. Using panel data set for a period of about 20 years (1981-2002), Xing and Wan (2006) exhibit that competition between China and four other large Asian economies (Thailand, Malaysia, Indonesia, and Philippines) for Japanese foreign direct investments in Asian manufacturing industry was significantly affected by the relative real appreciation of the currencies of these countries against the Japanese yen, and that the redirection of Japan’s FDI from these Asian countries to China was greatly attributed to the depreciation of the Chinese Yuan, particularly in the 80s and early 1990s. Also, other studies indicate that there is no significant evidence as to the long-term relationship between the exchange rate and FDI inflows in Western developed countries (Halicioglu. F., 2001).

In addition, many studies have always indicated that there exists a positive correlation between FDI flows and the exchange rates especially in the short-run. In fact, since the 1980s, many studies had indicated that a country tends to receive more FDI inflows when its currency depreciates and this was mainly because it made domestic goods be a bit of cheaper. But most of these studies conducted there research based on data collected from the US and developed countries and thereby not giving a full picture of exchange rates on FDI flows on a globalized perspective. Even so some economists have constantly disagreed with the findings and overall conclusions made on them (Shi. J., 2014).

However, in the late 1990, several studies started focusing more on both developing and developed countries on exchange rates and FDI flows. Bayoumi and Lipworth (1998) focused on Japanese FDI flows to various trading partners, and is among the early research works that used data on FDI flows to developing countries. As the years advanced several research works started using more comprehensive data that covered more developing countries as those which are developed. These included; Benassy-Quere et al. (2001), Kiyota and Urata (2004), and Xing (2006). Amazing, they come to the same conclusion that depreciation of the
host country currency tends to attract more FDI flows, in spite of the difference in data scope and methodology.

It is then clear that the level of exchange rate affects FDI in various ways, depending on the destination of the goods produced. If the foreign investor intends to produce for the local market, FDI and trade could be considered as substitutes. In that case, as examined by the prior researchers, an appreciation of the local currency will definitely increase FDI inflows by increasing the purchasing power of local consumers. On the other hand, a depreciation in the real exchange rate of the recipient country increases FDI by reducing the cost of capital (Chowdhury. A. R. and Wheeler. M., 2008). Esquivel and Larrain (2002) found out that potential investors will invest foreign country as long as the expected returns on investments are high enough to cover currency risk. Hence, FDI flows will be expected to be lower when exchange rate volatility is higher.

Kandiero and Chitiga (2006) found out an inverse relationship between real exchange rates and FDI flows after using data for 38 African countries. Coleman and Tettey (2008) also supports the above findings and further states that real exchange rates are a significant factor in terms of attracting FDI inflows. Their research was however, focused on Ghana and was aimed at finding how exchange rate volatility impacts on FDI flows. They then conclude that the real exchange rate volatility has a negative influence on FDI inflows in Ghana. This simply means that exchange rate fluctuations, measure of risk, decreases FDI inflows.

Moreover, the level of openness of the economy of a country to foreign investors gives them the advantage of taking economic opportunities that are open to them, and a suitable exchange rate propels them to do so (Oladipo. S. O., 2013). This is because the value for their foreign currency can accumulate a very significant proportion of the domestic currency. Findings from Ayanwale (2007), Asiedu (2006), and Dind (2009) support this result.

Therefore, macroeconomic stability should always remain the top policy priority for the government and all its stakeholders. The country is facing potential risks emanating from both internal and external imbalances. The macroeconomic landscape depicts increasing fiscal pressure arising from the implementation of Medium Term Plans and Vision 2030, on devolution, growing current account deficit, and an investment-thrift resource gap. The country’s economic growth still remains vulnerable to external shocks, especially from the global economy, regional stability and security, and weather-related supply shocks. On the
domestic front, political risk and national cohesion are still challenges to deal with in order to bolster business confidence and reduce high economic uncertainties (Kenya Economic Report, 2013).
2.6. Chapter Summary

Therefore, the country is in no doubt having the potential for increased foreign direct investment flows and be a suitable regional hub for multinational subsidiaries but if macroeconomic stability is maintained, will it be in that position. This has to be done in manner that macroeconomic factors do not implicate on foreign direct investment negatively.

The next chapter will then focus on the research design, data collection and analysis techniques for the study. This will assist in drawing objective findings which will guide in drafting recommendations for this topic.
CHAPTER THREE

3.0. RESEARCH METHODOLOGY

3.1. Introduction
This chapter was set to address the methods and procedures used to carry out the research work. It actually has a direct influence on the results and findings, and hence very significant and important in the research work progress. Therefore, it entailed research design, population and sampling design, data collection methods, the research procedures, and data analysis methods that was used.

3.2. Research Design
The research work focused on implications of macroeconomic policies on foreign direct investment in Kenya and therefore was a descriptive study. This is largely because the study goes beyond description and attempts to explain the implications that macroeconomic policies has on foreign direct investments in the country.

Therefore, the research design that was used was correlation design and with a linear regression model. This design normally seeks to study the relationship between two or more variables (Cooper. R. D. and Schindler. S. P., 2003).

The research design was used because the variables that were being studied fell on either independent and dependent categories hence the design was suitable in determining the relationship that existed between the variables. That relationship entailed and described the specific objectives of this study extensively.

Normally, simple linear regression model and correlation are techniques in parametric statistics that are commonly used for analyzing the relationship between an independent and dependent variables. They are commonly used by most authors because they are easy to use and give an almost accurate relationship between variables.
3.3. Population and Sampling Design

3.3.1. Population
The population of a given study is normally a set of all the individual particulars in that given study. The study was based on the implications of macroeconomic policies on FDI flows in the country. Therefore, the population consisted of the entire macroeconomic performance data and FDI data for the period of 2002 to 2013. In particular, the population consisted of the actual FDI inflow to GDP net value, Real Interest Rates, Inflation rates, Development Expenditure (Infrastructure), and Real Exchange Rates of the country for the period of study. This population is too large given the constant changes in the variables above. The studies then narrows down to a period of 2002 to 2013, thus a total of 12 observations were made for each of the five variables.

3.3.2. Sampling Design

3.3.2.1. Sampling Technique
The study used a non-probability sampling technique. In particular, the study adopted the judgmental sampling or rather purposive sampling. The researcher studied the variable under the research using the most recent secondary data available from the country (Kenya).

3.3.2.3. Sample Size
According to Saunders, Lewis and Thornhill (2002), many researchers argue that using sampling enables a higher overall accuracy. The smaller the size of the sample, the easier for the researcher to have adequate time and resources to reconnaissance, pilot and design the means of collecting the data.

The period covered for the study from 2002 and 2013 was where the sample size of all variables was drawn from. This period is selected because it is long enough to give a good indication as to the effect of macroeconomic policy on the foreign direct investment flows into the country. The data to be collected with regards to FDI flows is from World Bank Database; while the other variables that were used required data from the Kenya National Bureau of Statistics (KNBS), various issues and reports of the Government Finance Statistics Yearbook, International Monetary Fund; Monthly reports by the Central Bank of Kenya (CBK).
3.4. Data Collection Methods
The main method of collecting for this study was the desk study. Secondary data was deployed here. The data that was used included; approved economic reports, validated documents, and historic data. Two checklists were used to collect data for the study. The first checklist focused on independent variables such as inflation rates, exchange rates, infrastructural expenditure, and interest rates. The second checklist outlined dependent variables such as; foreign direct investment inflows in value and as an aggregate to the real GDP. All the checklists were used in collecting data under the period of study (See: Appendix).

3.5. Research Procedures
The researcher did a pilot testing on a number of selected time periods, for instance; from 2002 to 2005; and 2006 to 2012; to find out whether there was consistency in the study. This test is normally conducted to detect weaknesses in research design and instrumentation and to provide proxy data for selection of a probability sample. It is normally intended to reveal errors in the design and improper control of extraneous or environmental conditions (Cooper. R. D. and Schindler. S. P., 2003). Correlation was conducted on the values drawn from different periods and it was found out that there was consistency in the data collected.

Samples to be collected and used in the analysis were collected on an annual basis. The yearly data was accessible and available for usage in the research process. The checklist on the appendix was developed based on the specific objectives as laid out in the first chapter.

3.6. Data Analysis Methods
Data analysis was conducted by use of inferential and descriptive statistics where correlation and regression analysis was used for the research work covering the period of 2002 to 2013. The mean and standard deviation were also incorporated in the study. Regression and correlation methodology was used in order to establish the relationship between FDI inflows and the macroeconomic policy in the country. The independent variables used in the study include: Inflation Rates, Recurrent Expenditure, Infrastructure Expenditure, Real GDP, Real Interest Rates, and Exchange Rates. The dependent variable will be Foreign Direct Flows to the country. The trend of the FDI inflow was then analyzed during the period of study and compared with the macroeconomic policy variables, that is; exchange rates, interest rates, infrastructure expenditure, and the inflation rates with the help of Microsoft Excel.
The corresponding findings was interpreted based on the correlation coefficient and linear regression model, as follow;

- \( P= 1 \), 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.

The value of the sample correlation coefficient is normally used to estimate the true population correlation. Large correlation coefficients always indicate that one variable has a huge influence on the other variable or the relationship is casual or that the variables being correlated have a number of characteristics in common. In contrast, small correlation coefficient normally indicate that the variables are possibly not linearly related.

Furthermore, a test for the significance of the correlation coefficient is involved too. This is done in order to find out if the value is significantly greater than zero. A 5 percent significance level was used in the study.

Correlation coefficient is given as;

\[
Cor_{xy} = \frac{COV_{xy}}{\sigma_x \sigma_y}
\]

\[
Cor_{xy} = \frac{\sum (x_i - \mu_x)(y_i - \mu_y)}{\sum (x_i - \mu_x)^2 \sum (y_i - \mu_y)^2}
\]

Where;

- \( Cor_{xy} \), is the correlation coefficient between the variable x and y
- \( COV_{xy} \), is the covariance between variable x and y
- \( \sigma_x \), is the standard deviation of x
- \( \sigma_y \), is the standard deviation of y
- \( x_i \), is the \( ith \) observation of variable x
- \( y_i \), is the \( ith \) observation of variable y
\( \mu_x \), is the mean of variable \( x \)

\( \mu_y \), is the mean of variable \( y \)

Also, linear regression analysis is a quantitative research method that is normally used when conducting a study involving bivariate and multivariate variables. It assists in analyzing a relationship between independent and dependent variables. The standard form of a regression model includes unknown parameters (\( \beta \)), independent variables (\( X \)), and the dependent variables (\( Y \)). A regression model normally specifies the relationship between a dependent variable (\( Y \)) to a function combination of independent variables (\( X \)) and an unknown parameter. A regression equation is always used to predict the above relationship (Dudovskiy. J., 2012). The formula for regression equation is;

\[
y = a + bx
\]

Where,

\[
b = \frac{n \sum xy - (\sum x)(\sum y)}{n(\sum x^2) - (\sum x)^2}
\]

\[
a = \frac{\sum y - b \sum x}{n}
\]

\( b \), the slope of the regression line

\( a \), the intercept point of the regression line and the \( y \) axis

\( n \), number of values or variables
3.7. Chapter Summary

This chapter mainly describes the methods that will be used in conducting the study if not the research work. A descriptive study will take its entire design and the data collected will rely heavily on credible sources such as the Kenya National Bureau of Statistics, Central Bank of Kenya, and International Organizations such as the World Bank and UNCTAD.
CHAPTER FOUR

4.0. RESULTS AND FINDINGS

4.1. Introduction
This chapter outlays the results and findings of the research work. The main purpose for this research work is to determine the extent to which macroeconomic policy implicates on the foreign direct investment (FDI) inflows in the country. It relied on secondary data, as stated in the previous chapter. Correlation and regression of the data collected was used to determine the relationship between FDI inflows and the selected macroeconomic policy factors. Table indicating the data that has been collected for the analysis is in the appendix.

4.2. General Trends

4.2.1. FDI Inflows in Kenya
Over the past decades, Kenya has been a comparative underperformer in terms of attracting FDI in the East African region. Although the country’s performance in attracting FDI has been improving gradually with massive reforms in various sectors in the economy, it has managed to top neighboring East African nations; Uganda and Tanzania in dollar terms, because of its positioning as a regional hub of various multinationals. In fact, the World Investment Report, 2008 described the country as the least favorable destination of FDI in the East African region (UNCTAD, 2008). This stand was arrived at after the country had enjoyed a whooping US$729 million in FDI inflows; about 2.7% of its GDP, in 2007; and then slammed to receiving only about US$96 million, which was about 0.3% of its GDP in 2008. This value had dropped significantly because the country was in intensive chaos after its General Elections conducted towards the end of 2007. But the value started increasing gradually as peace set in, and it received US$141 million and US$186 million in 2009 and 2010 respectively (World Bank, 2010).

In the year 2013, FDI flows into the country stood at about $514 million (Shs.45.18 billion), up from $259 million (Shs.22.7 billion) in 2012, which is a 98 percent increment. These flows majorly went to oil and gas, and the manufacturing industries. The country is also perceived by foreign investors as a regional hub for energy, services and manufacturing. However, the country’s share of FDI inflows is also seen as smaller than its East African
neighbors, with flows to the East African region standing at $6.2 billion (Shs.545 billion) in 2013 (UNCTAD., 2014).

The FDI inflows to GDP have been improving in the country as stipulated by Figure 4.20. This has been attributed to the good political stability and discovery of oil and gas in the country (Irungu. G., 2014).

![Figure 4.20; Foreign Direct Investment Flows in Kenya (World Economic Indicators, 2014)](image)

According to table 4.20 and 4.21, the country received the highest FDI inflows to GDP in 2013 and the lowest flow in 2002. This was always attributed to the massive oil and gas exploration in the country coupled with improvements in infrastructure and steady economic growth. The flows have been fluctuating overtime ever since 2002 to 2013, with a significant deep in 2008; attributed majorly by the high political instability as a result of post-election violence that rocked the country.

It is however, clear that since 2009, the rate of FDI inflows to GDP in the country started increasing steadily again, with 2013 receiving the highest amount of inflows to GDP, but not as that which was received in 2007.
Table 4.20; Descriptive data on FDI inflows in Kenya

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>YEAR</td>
<td>12</td>
<td>2002</td>
<td>2013</td>
</tr>
<tr>
<td>FDI net inflows of GDP</td>
<td>12</td>
<td>.11320</td>
<td>2.28124</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td>12</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Furthermore, the descriptive statistic in the table below indicate that, the mean average of the FDI inflows to GDP in the country, was about 0.5754 (5.8%) with a standard deviation of around 0.5913 (5.9%) and a median of 0.3796 (3.8%). This depicts the significant fluctuations in FDI inflows in the country for the period of study.

Table 4.21; Descriptive data on FDI inflows in Kenya

<table>
<thead>
<tr>
<th></th>
<th>Valid</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>12</td>
<td>Missing</td>
<td>0</td>
</tr>
<tr>
<td>Mean</td>
<td>.5753998</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>.3795937</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mode</td>
<td>.11320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>.5913274</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.2.2. Interest Rates in Kenya

The history of interest rates in the country dates back to when the Structural Adjustment Programs (SAPs) were being implemented. At this point in time, the Central Bank of Kenya (CBK) had started tightening the monetary policy so as to allow for improvements in the financial markets, stabilize the exchange rates, liberalize trade and tighten prudential regulations in the economy. This was in the 90s up to the beginning of the 21st century; and the high real short-term interest rates had reduced the demand for capital market instruments and crowded-out most foreign direct investors and thereby making local investment had. For instance, in 2001, the Treasury bill (T-bill) rate was at 12.6 percent compared to the prevailing inflation rate of 0.8 percent and hence this drove the market interest rates high and causing a reduction in overall investments across the country (Olweny. T., 2011).
The T-bill rate is generally regarded as an indicator of the interest rate policy being pursued by any given government, and a benchmark for the rates charged by commercial banks (Garr. K. D. and Kyereboah-Coleman., 2013). So in 2003 and 2004, the T-bill rate declined drastically to a level of 0.83 percent at the start of the fourth quarter and by the end of the same quarter, it had gone to 8.04 percent; this was with the aim of stabilizing the short-term interest rates in the country. According to the CBK, the stability of short-term interest rates between 8 and 9 percent is very vital to the financial sector and overall economic prowess of the country. The CBK had to be the sole regulator here so as to tame commercial banks over the exploitation of market interest rates and thereby encourage rates that are reasonable to investors (Olweny. T., 2011). As stated by Tandelilin (2007) and Bawumia (2010), the enforcement of regulations such as the reserve limits normally limits commercial banks from over-issuing liabilities or diverting assets into high-risk ventures.

In summary, the stability of the local prevailing interest rates by the help of CBK through the Central Bank Rate (CBR) has contributed to the certainty and predictability in the macroeconomic environment for both local and foreign investors. This is a crucial factor to FDI inflows to the country as it boosts their confidence in investments (Figure 4.21).

![Figure 4.21; Interest Rate Trends in Kenya (Central Bank of Kenya)](image)

34
4.2.3. Development Expenditure in Kenya

In the 2014/15 budget spending, about 90 percent of the funds allocated for infrastructure goes to construction of roads and bridges, with a fifth of which set aside for maintenance of roads. For instance, expansion of JKIA commuter rail, estimated at about Kshs.3.5 billion, and construction of the Standard Gauge Rail, at around Kshs.19.4 billion. Also, about Kshs.3.5 billion is set aside for enhancing security status at JKIA, and modernizing and upgrading the capacity and safety of the port of Mombasa (Rono. E. et al., 2014).

Therefore, in spite of the government’s effort to expand on its expenditure by increasing budgetary allocation, the state of affairs indicate that its global competitiveness is still weak, attributed to the high cost of energy, and doing business, with the overall infrastructure deficit. This is also largely because the rate of executing these projects under infrastructure is at around 63 percent, which is the lowest compared with other sectors (KNBS., 2014).

4.2.4. Inflation Rate in Kenya

The key monetary policy objective in the country is to maintain price stability, defined as an overall inflation target of a range of 5 ± 2 percent. In 2011, the country faced inflationary pressure that was attributed to high international oil prices, drought conditions, and exchange rate depreciation. As a result, the inflation rate increased to a peak of 19.72 percent in November 2011, prompting the Central Bank of Kenya to adopt a tight monetary environment.

The Central Bank of Kenya then raised the Central Bank Rate (CBR) from 6.25 percent to 18 percent towards the end of 2011. That tight monetary policy was maintained till mid-2012 when the CBR was lowered to 16.5 percent and further to 13 percent in August 2012. This was in response to improving inflation outlook in the country contributed by improve supply of basic foods, lower international oil prices, and lower costs of electricity.
Figure 4.22: Inflation Rates in Kenya (Kenya National Bureau of Statistics)

The fluctuations in the overall inflation rates in the country in 2011 had a severe impact on several components of the economy; it affected the cost of doing business in the country which in turn spilled over to the price of domestic commodities. The cost of both goods and services become very volatile and the end consumer marginal propensity to consume went up. FDI flows were significantly affected too as it reduced their marginal income and hence realizing a decline in the rate of return on their investments.

Even before the 2011 inflationary crisis, Figure 4.22; clearly shows that the country has been experiencing large fluctuations in inflation rates in the recent years. It is noted that inflation accelerated from about 3 percent at the beginning of 2007 to 16 percent by mid-2008, and it reversed in mid-2010, and then increased again to around 20 percent by the end of 2011.

Andrle et al. (2013), found out that political crisis in end 2007, imported and domestic food shocks contributed immensely on the inflation dynamics experienced in the country in 2008 and now. Accommodative monetary policies formulated and regulated by the Central Bank also played a significant role on the inflation rates in the country. Around 2007 to 2008, the inflationary pressure in the country was neutralized by the disinflationary forces associated with the global recession, without much tightening of the monetary policy by the Central Bank of the country. It was also discovered that, short term interest rates needed to increase in order to offset the inflationary pressure by the end of 2011.
All in all, Kenya fits the description of most SSA countries; it pursued an inflation objective in the context of a managed float, but with a variety of instruments and intermediate targets.

4.2.5. Exchange Rates in Kenya

The Central Bank of Kenya has in the past few years adopted a tight monetary policy stance, through the Monetary Policy Committee, in order to stabilize the country’s exchange rate. An appreciation of the country’s currency against all major currencies was recorded from December 2011 through to the first half of 2012. It is expected that the Central Bank will continue pursuing a tight monetary policy that will support price and exchange rate stability, both in the short and medium term periods (KNBS., 2014). The main challenge that will be facing the country this year is that the US economy has pick and is growing and that means that the dollar is appreciating too. That technically implies that importers will be spending more to buy goods and services which will then increase the cost of goods and services in the country. This may impact negatively on the FDI flows in the country if the export base and tight monetary measures are not put in place (Namata, 2015).

![Figure 4.23; Kenya Shilling against other Major Currencies (Central Bank of Kenya, 2014)](image-url)

Figure 4.23; Kenya Shilling against other Major Currencies (Central Bank of Kenya, 2014)
4.3. Effect of the Real Interest Rate on FDIs flows

4.3.1 Correlation Analysis

The main objective of this study is to access the implications that macroeconomic policy has on the FDI inflows to the country. Interest rates are an integral part of the macroeconomic policy and therefore are the first variable in this study that represents the macroeconomic policy amongst other variables. The null hypothesis, H₀, is that interest rates have no implications on the FDI inflows to the country, while the alternative hypothesis, H₁, states that; interest rates have a significant implication on the FDI inflows in the country.

With the help of Pearson Correlation method, the researcher was in a position of determining the strength and direction of the variables. The direction for which could have been either positive (+) or negative (−) or indifferent (0).

From table 4.30, it is quite evident that the correlation between FDI inflows and the Interest Rates (Cost of Borrowing) is -0.065. This implies that the correlation between the two variables is negative.

Table 4.30; Correlation Analysis on FDI inflows and Real Interest Rates in Kenya

<table>
<thead>
<tr>
<th></th>
<th>FDI net inflows of GDP</th>
<th>Real Interest Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI net inflows of GDP</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.840</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>12</td>
</tr>
<tr>
<td>Real Interest Rates</td>
<td>Pearson Correlation</td>
<td>-.065</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.840</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>12</td>
</tr>
</tbody>
</table>

Furthermore, according to the table 4.3.1, any unit change in real interest rates in the country, it will have a net effect on the FDI inflows. That is, if the real interest rates was set to increase by a unit, then the FDI Inflows to GDP in the country will decrease by 0.065 in percentage. The significance of this relationship is at 0.84 confidence level.
4.3.2 Regression Analysis

The regression analysis is normally based on a model that is used to determine or develop a desirable linear relationship between two variables which are then used to predict an unknown variable. The model has the formation as of 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 the absence of \( X \); and \( B_1 \), is the change in the value of \( Y \) with every unit change in the value of \( X \).

Therefore, in the case of this research, the \( B_0 \) is 0.833 and \( B_1 \) is -0.017. The \( X \) value in this study is the Real Interest Rates while the \( Y \) value is the FDI Inflows in the country. This then implies that;

\[ Y = 0.833 - 0.017X \]

This implies that even without real interest rates in the market, the value of FDI inflow to GDP would be at 0.833 percent. But under the influence of interest rates, then with a unit increase in the Real Interest rates, then the value of FDI Inflow to GDP will be decreasing by 0.017 percent (Table 4.3b).

Also, from the findings; it is evident that the relationship between real interest rates and FDI inflows to the country is insignificant. This is because the level of significance (p-value) is 0.84, which is higher than 0.05 percent, the standard level of significance.

**Table 4.31; Regression Analysis on FDI inflows and Real Interest Rates 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>.833</td>
<td>1.257</td>
<td>.663</td>
<td>.522</td>
<td>-.1967</td>
</tr>
<tr>
<td>Real Interest Rates</td>
<td>-.017</td>
<td>.082</td>
<td>-.065</td>
<td>-.207</td>
<td>.840</td>
</tr>
</tbody>
</table>

Finally, under the 95% Confidence Interval; with no influence of the real interest rates, then the FDI Inflow to GDP received by the country would be between the ranges of -1.967 to
3.633 percent. However, with the influence of real interest rates, such that any changes for which will affect the FDI Inflows to GDP by -0.199 to 0.165 per unit change annually (Table 4.31).

4.4 Effect of Development Expenditure on FDI flows

4.4.1 Correlation Analysis

Development Expenditure and therefore, Infrastructure Expenditure is an integral part of the macroeconomic policy and therefore is the second variable in this study that represents the macroeconomic policy amongst other variables. The null hypothesis, H0, is that infrastructure expenditure have no implications on the FDI inflows to the country, while the alternative hypothesis, H1, states that; infrastructure expenditure have a significant implication on the FDI inflows in the country.

From the table below, it is quite evident that the correlation between FDI inflows and the Development expenditure is 0.026. This implies that the correlation between the two variables is positive.

Table 4.40; Correlation Analysis on FDI inflows and Development Exp in Kenya

<table>
<thead>
<tr>
<th>FDI net inflows of GDP</th>
<th>Development Exp of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.166</td>
</tr>
<tr>
<td>N</td>
<td>12</td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.606</td>
</tr>
<tr>
<td>N</td>
<td>12</td>
</tr>
</tbody>
</table>

Therefore, according to the table 4.40, any unit change in development expenditure in the country, it will have a net positive effect on the FDI inflows. That is, if the development expenditure was set to increase by a unit, then the FDI Inflows to GDP in the country will also increase by 0.166 in percentage. The significance of this relationship is at 0.606 confidence level.
### 4.4.2 Regression Analysis

Using the following regression model;

\[ Y = B_0 + B_1X \]

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

The \( B_0 \) is 0.435 and \( B_1 \) is 0.318. The \( X \) value in this study is the Development expenditure while the \( Y \) value is the FDI Inflows to GDP in the country. This then implies that;

\[ Y = 0.435 + 0.003X \]

Also, it is worth noting that from the findings; it is evident that the relationship between development expenditure and FDI inflows to the country is insignificant. This is because the level of significance (p-value) is 0.606, which is higher than 0.05 percent, the standard level of significance.

**Table 4.41; Regression Analysis on FDI inflows and Development Exp 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>.435</td>
<td>.318</td>
<td></td>
<td></td>
<td>-.274</td>
</tr>
<tr>
<td>1</td>
<td>Development Exp of GDP</td>
<td>.003</td>
<td>.005</td>
<td>.166</td>
<td>.532</td>
</tr>
</tbody>
</table>

This implies that even without development expenditure, the value of FDI inflow to GDP would be 0.435 percent. But under the influence of infrastructure expenditure, then with a unit increase in the infrastructure expenditure, then the value of FDI Inflow to GDP will be increasing by 0.003 percent (Table 4.41).
4.5 Effect of Inflation rates to FDI flows

4.5.1 Correlation Analysis

Inflation rate is also an integral part of the macroeconomic policy and therefore is the third variable in this study that represents the macroeconomic policy amongst other variables. The null hypothesis, H0, is that inflation rates have no implications on the FDI inflows to the country, while the alternative hypothesis, H1, states that; inflation rates have a significant implication on the FDI inflows in the country.

Table 4.50; Correlation Analysis on FDI inflows and Inflation Rates in Kenya

<table>
<thead>
<tr>
<th></th>
<th>FDI net inflows of GDP</th>
<th>Inflation Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI net inflows of GDP</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>12</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>Pearson Correlation</td>
<td>-.093</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.774</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>12</td>
</tr>
</tbody>
</table>

From table 4.50, it is quite evident that the correlation between FDI inflows and the inflation rates is -0.093. This implies that the correlation between the two variables is negative.

Therefore, any unit change in inflation rates in the country, it will have a net negative effect on the FDI inflows. That is, if the inflation rate was set to increase by a unit, then the FDI Inflows to GDP in the country will also decrease by 0.093 in percentage. Also, with a net reduction of inflation rates per unit, the FDI Inflows to GDP will be set to increase by 0.093 percent. The significance of this relationship is at 0.774 confidence level.

4.5.2 Regression Analysis

Using the following regression model;

\[ Y = B_0 + B_1X \]

Where, Y is the dependent variable; X, is the independent variable; \( B_0 \), is the value of Y in the absence of X; and \( B_1 \), is the change in the value of Y with every unit change in the value of X.
The $B_0$ is 0.643 and $B_1$ is -0.01. The X value in this study is the inflation rate while the Y value is the FDI Inflows to GDP in the country. This then implies that:

$$Y = 0.643 - 0.01X$$

**Table 4.51: Regression Analysis on FDI inflows and Inflation Rates 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>1</td>
<td>(Constant)</td>
<td>.643</td>
<td>.290</td>
<td>2.214</td>
<td>.051</td>
</tr>
<tr>
<td></td>
<td>Inflation Rate</td>
<td>-.010</td>
<td>.035</td>
<td>-.093</td>
<td>-.294</td>
</tr>
</tbody>
</table>

Also, it is evident that the relationship between inflation rates and FDI inflows to the country is insignificant. This is because the level of significance (p-value) is 0.774, which is higher than 0.05 percent, the standard level of significance. Consequently, the findings reveal that even without any effects of inflation rates in the market, the value of FDI inflow to GDP would be at 0.643 percent. But under the influence of inflation rates, then with a unit increase in the rate of inflation, then the value of FDI Inflow to GDP will be decreasing by 0.01 percent (Table 4.51).

Finally, under the 95% Confidence Interval; with no influence of the inflation rates, then the FDI Inflow to GDP received by the country would be between the ranges of -0.004 to 1.29 percent. However, with the influence of inflation rates, such that any changes for which will affect the FDI Inflows to GDP by -0.087 to 0.067 per unit change annually.

**4.6 Effect of Real Exchange Rates on FDI flows**

**4.6.1 Correlation Analysis**

Inflation rate is also an integral part of the macroeconomic policy and therefore is the third variable in this study that represents the macroeconomic policy amongst other variables. The null hypothesis, H0, is that real exchange rates have no implications on the FDI inflows to the country, while the alternative hypothesis, H1, states that; real exchange rates have a significant implication on the FDI inflows in the country.
From Table 4.60, it is quite evident that the correlation between FDI inflows and the real exchange rates is -0.183. This implies that the correlation between the two variables is negative.

Therefore, any unit change in real exchange rates in the country, it will have a net negative effect on the FDI inflows. That is, if the real exchange rates was set to increase by a unit, then the FDI inflows to GDP in the country will also decrease by 0.183 in percentage. Also, with a net reduction of real exchange rates per unit, the FDI inflows to GDP will be set to increase by 0.183 percent. The significance of this relationship is at 0.568 confidence level.

### 4.6.2 Regression Analysis

Using the following regression model:

\[ Y = B_0 + B_1X \]

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

The \( B_0 \) is 1.873 and \( B_1 \) is -0.17. The X value in this study is the real exchange rates while the Y value is the FDI inflows to GDP in the country. This then implies that;

\[ Y = 1.873 - 0.017X \]
Table 4.61; Regression Analysis on FDI inflows and Real Exchange Rates 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>1.873</td>
<td>2.206</td>
<td>.849</td>
<td>.416</td>
<td>-3.042</td>
</tr>
<tr>
<td>Real Exchange Rates (USD)</td>
<td>-.017</td>
<td>.028</td>
<td>-.183</td>
<td>-.590</td>
<td>.568</td>
</tr>
</tbody>
</table>

This implies that even without any effects of inflation rates in the market, the value of FDI inflow to GDP would be at 0.643 percent. But under the influence of inflation rates, then with a unit increase in the rate of inflation, then the value of FDI Inflow to GDP will be decreasing by 0.01 percent (Table 4.61).

Also, the findings have revealed that, the relationship between real exchange rates and FDI inflows to the country is insignificant. This is because the level of significance (p-value) is 0.568, which is higher than 0.05 percent, the standard level of significance.

Finally, under the 95% Confidence Interval; with no influence of the real exchange rates, then the FDI Inflow to GDP received by the country would be between the ranges of -3.042 to 6.787 percent. However, with the influence of real exchange rates such that any changes for which will affect the FDI Inflows to GDP by -0.080 to 0.046 per unit change annually (Table 4.61).
4.7 Chapter Summary

The chapter covered more on data analysis and presentation in tables and figures for easier and better understanding. The researcher came to notice that the Real Interest Rates, Inflation rates, and Real Exchange rates have a negative correlation to the FDI Inflows to GDP on an annual basis. The Infrastructure Expenditure represented by the Development Expenditure had a positive correlation to the Foreign Direct Investments to Gross Domestic Product. Therefore, the next chapter will continue to expand on the conclusion and recommendations from the analysis done on this chapter.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

This chapter represents a summary of discussion for the research work, concluding remarks according to the outcome, and various recommendations that are suitable for implementation. The first section for the chapter outlays a summary of the purpose for which the research was conducted, the specific research objectives, a summary of the methodology implemented, and a highlight on the results and findings of the research. The next section discusses the results and findings of the research work. The third section, will further illustrate the conclusions derived from the discussions. Finally, the last bit focuses on the proposed recommendations as per the specific objectives for the research.

5.2 Summary

The main objective of this research is to find out the implications of macroeconomic policy formulated by the country on foreign direct investment over a given period of time, which is 12 years (2002 to 2013). The research work was assisted by the following specific objectives: (i) To determine the extent to which interest rates influences FDI flows in the economy of the country; (ii) To determine the extent to which infrastructure expenditure influences FDI flows in the country; (iii) To assess how inflation rates influence FDI flows in the country’s economy; (iv) To determine how exchange rates influence FDI flows in the country.

The research work also employed descriptive research design in terms of collecting and analyzing data used. Secondary data was used for analysis and getting the findings. The data was collected from the World Bank Database, Central Bank of Kenya, Kenya National Bureau of Statistics, and United Nations Conference on Trade and Development (UNCTAD) Database. Regression, Correlation, and Descriptive statistical analysis were used to analyze the data collected. Statistical Package for Social Sciences (SPSS) system was used to aid the researcher in data analysis and presentation, in terms of charts and tables. The findings from the data analyzed, revealed mixed results for each and every specific objective. There was a negative relationship between interest rates, inflation rates, and real exchange rates to the FDI
inflows in the country. However, there is a positive relationship between infrastructure expenditure (development expenditure) and the FDI inflows in the country.

In the first specific objective’s finding of the research, it is quite clear that there were some trends between the real interest rates and the foreign direct investments in the country. There is a conclusive relationship that can be harmonized form these trends. The trends have been taken from a twelve year time period where by the real interest rates and the FDI inflows moved in the opposite directions. In fact, the correlation coefficient between the two variables was -0.065, indicating a negative relationship between the variables. But this relationship is almost insignificant for a conclusion to be made.

Moreover, the second specific objective’s finding revealed that there are some trends too between infrastructure expenditure and FDI inflows in the country and there was a conclusive relationship that was observed from these trends over the twelve years of study. The trend too showed that the movement between the two variables was on the same direction. That is, the relationship between the two variables was a positive one with a correlation coefficient of +0.166.

Furthermore, the third specific objective’s finding depicted that there are some trends between inflation rates and FDI inflows in the country. The trend indicates that both the variables tend to move towards the opposite direction. That is, the relationship is negative with a correlation coefficient of -0.093.

Finally, the last specific objective’s finding signaled that there are some trends between real exchange rates and FDI inflows in the country. The trend indicates that both the variables tend to move towards the opposite direction. That is, the relationship is negative with a correlation coefficient of -0.183.
5.3 Discussion of the Results

5.3.1 Analysis of Real Interest Rates on FDI inflows

From the finding on interest rates on FDI inflows in the country, the relationship seemed insignificant; indicating that real interest rates have no major effects on the FDI flows the country receives. Nonnemberg and Mendonça (2004) investigated the determinants of FDI in developing economies. They performed an econometric model based on panel data analysis for 38 developing countries from 1975 to 2000 (25 years). They found out that the level of schooling, economy’s degree of openness, risk and variables related to macroeconomic performance such as inflation, risk, and growth rate (GDP) and stock market performance impacted on FDI inflows. The cost of borrowing was found to be insignificant.

Furthermore, Uygur (2005) investigates the determinants and importance of FDI for Türkiye for the period of 1992-2004 by employing the VAR model. In the research work, he examined all major macroeconomic factors such as real interest rate, inflation rate, investment atmosphere, export rate, growth rate, and budget deficit rate. He then finds out that the real interest rate of official treasury department and consolidated budget balance being the main determinants of FDI for Türkiye.

Arbatli (2011), did a research on economic policies and FDI inflows to emerging market economies with the use of autoregressive integrated moving average (ARIMA). The data sample was for 46 countries and the study period was from 1990 to 2009. He found out that inflation rate has a mild or insignificant effect on FDI inflows in emerging market economies.

Onyeiwu and Shrestha (2004); Bevan and Estrin (2004), had a different outlook, especially on FDI inflows to Africa and transition economies. They tend to discover that real interest rates are not a major significance to the FDI inflows in most African countries. Onyeiwu (2004), having done a study on determinants of FDI flows in Sub-saharan Africa and using the fixed effects model, random effect mode; and two step procedure in different studies; concluded that the relationship between real interest rates and FDI flows is very insignificant. This is well in line with the researchers findings.

A study done on FDI flows into Zimbabwe found out that, interest rates do not affect the level of FDI flows into the country. The study used CLRM econometric model and came to realize that high interest rates insignificantly affects FDI flows into Zimbabwe. The CLRM
model that was used had a high explanatory power and adequately predicted the negative relationship between FDI inflows and risk factors. The research also found out that risk factors are the most significant determinant of FDI inflows into Zimbabwe. These are the factors that do suppress the levels of FDI and hence hinders growth and development of the nation’s economy. The research then recommended that the Zimbabwean government should ensure that accountability and transparency on all macroeconomic policy issues among others (Anna, C. et al., 2012.).

Dabla-Norris et al (2010) found out that low income economies as those found in Africa, are very sensitive to interest rate movements or changes in financing conditions from developed economies. They also realize that FDI is increasingly being associated with growth in developing countries during the recent period of globalization. They continue by stating that real interest rate sensitivity of FDI outflows to developing economies could reflect a variety of reasons. That is, they are important because they can influence real prices of mineral resources and other commodities, where most of the FDI flows to developing economies is largely concentrated (Frankel. J., 2008). Therefore, this argument is in line with the nation that financing FDI operations in extractive sector differs with that for equity investment, a mode of sourcing funds in non-extractive economies.

5.3.2 Analysis of Infrastructural Expenditure on FDI inflows

From the findings on the research work, it is clear that infrastructural expenditure has a significant relationship with the FDI inflows in the country. The relationship is quite positive, with all the variables being affected in the same manner. Also, Asiedu (2002), after conducting a study on determinants of FDI to developing countries, in Africa; realized that there is a positive correlation between infrastructure and FDI inflows to a country. She used regression analysis in analyzing secondary data for this study. She came to find out that; better infrastructure has a positive impact on FDI. She further found out that, all being constant; infrastructure promotes FDI to non-SSA countries, but has no significant impact on FDI flows to SSA countries.

Asiedu (2006) also did another study, which involved 22 countries in Sub-Saharan Africa over the period of 1984 to 2000. The method for analyzing the data was regression analysis while data collected was from a secondary source. She found out that good infrastructure was one of the factors that promoted foreign direct investment in most African countries.
Furthermore, Kok and Ersoy (2009), did a study on the best determinants of foreign direct investment in developing countries. The authors used panel data and cross-section SUR (seemingly unrelated regression) on 24 developing countries over a period of 27 years (1976-2003). They later found out that infrastructure had a positive effect on FDI inflows to these countries.

Khadaroo and Seetanah (2010), also conducted a study on transport infrastructure and FDI in Sub-Saharan African economies. With the help of both static and dynamic panel data analysis approach; they were able to analyze data for 33 SSA countries for a period of 1984 to 2002. The authors found out that infrastructure availability was and is a contributing factor to the relative attractiveness of FDIs to these SSA countries. The results from there analysis further showed that transportation capital has been an important factor in making the countries attractive to FDI flows in the short and long run basis.

Ezeoha and Cattaneo (2011), also come to find that among other factors; infrastructural development had a positive strong positive impact on FDI flows in the Sub-Saharan countries. Hence, it plays a major role in attracting and sustaining FDI flows, more especially to non-resource endowed countries than is to resource endowed countries. The researchers then proceed to suggest that among the others factors that should be looked at when formulating policies that would be investor friendly; allocation of more resources to infrastructural development would be a key component.

In fact, Deutche Bank Research (2013); observed that governments in most SSA countries are spending more to reduce infrastructural deficits which could otherwise inhibit their competitive advantage and hence growth. This is also after them discovering that infrastructural deficits depressed firm-level productivity by about 40 percent and that investment infrastructural development could boost the GDP of the region by around 2 percentage points. The research also recommended that continued investment in infrastructural development will be critical to maintaining and sustaining economic growth over the medium term period.

Therefore, Khadaroo and Seetanah (2010), Kok and Ersoy (2009), Asiedu (2002, 2006); found positive impact whereas, Quazi (2005) claims insignificant effect of infrastructure on FDI.
5.3.3 Analysis of Inflation Rates on FDI inflows

According to the findings on this objective, it is quite evident that inflation rates in the country have some significance to the FDI inflows it receives. The relationship between the two variables is opposite in nature and so the correlation coefficient is negative. Onyeiwu and Shrestha (2004), did a study on this using fixed and random effects model to explore on the determinants of FDI flows in Africa. Based on a panel dataset for 29 African countries over the period 1975 to 1999, the researchers found out that inflation rates are one of the factors that are significant for FDI flows in most African countries.

In Asia, whose countries bear resemblance to some African countries; an inflation rate was found to have a significant effect on the FDI inflows in most of its countries. Aw and Tang (2010), did a research on Malaysia on the determinants of inward FDI. They used Engel-granger test and OLS method and found out that inflation rates have a significant impact on FDI flows in the country. Whereas, Singhania and Gupta (2002); did a study on the determinants of FDI in India using the best fit model to explain this study. The authors tested for various assumptions taken before applying autoregressive integrated moving average (ARIMA) using standard tests and quantified FDI policy changes using dummy variables. They found out that inflation rates among other macroeconomic variables were significant to FDI policy changes and hence their inflows.

However, some authors have come out to dismiss the significant relationship between inflation rates and FDI flows. Arbatli (2011), did a research on economic policies and FDI inflows to emerging market economies with the use of autoregressive integrated moving average (ARIMA). The data sample was for 46 countries and the study period was from 1990 to 2009. He found out that inflation rate has a mild or insignificant effect on FDI inflows in emerging market economies.

Ezeoha and Cattaneo (2011), also came to find out that inflation rate has a significantly positive effect on FDI flows especially in Sub-Saharan countries. The positive role of inflation rates could have been because rising inflation rates is sometimes a consequent of hike of economic activities (Sayek, 2009). They then suggest from their findings that; removing restrictions like direct inflation and interest rates control practices; would be a better way of encouraging for FDI inflows.
High inflation rates always occurs in isolation from other macroeconomic challenges; time series or cross-country regression models and analysis that normally show a cost of inflation on growth or output are not always convincing, since it is difficult to hold everything constant. For instance, for inflation rates over 35 percent per annum, a retarded economic growth is depicted (Easterly, 2001; and Rogoff and Reinhart, 2002). But for lower inflation rates of below 35 percent per annum, the evidence is more limited. Hence, this is not to say that a country that has an inflation rate of about 8 percent is not better off than a country with an inflation rate of 15 percent, and that an economy with an inflation rate of about 1.7 percent is not well off than one with 11 percent. All in all, the overall reduction in inflation rates that has taken place across much of the globe over the past five to ten years has almost been a factor in increasing global economic and macroeconomic stability.

5.3.4 Analysis of Real Exchange Rates on FDI inflows

A sound macroeconomic environment promotes FDI flows by indicating a less investment risk. High exchange rate against the US dollar, depreciated currency, will attract higher FDI while the vice versa ultimately dissuades FDI. This is because real exchange rate allows an economy to determine the effect of relative wealth and labor costs on FDI inflows. That is, a depreciation of that economy’s real exchange rate will certainly increase the relative wealth of the foreign investors and lead to an increase in foreign purchases of domestic assets. Also, this may lead to capital inflows as foreign investors will try and take advantage of relatively affordable domestic human capital (Anyanwu, 2012).

Very limited studies have been done in order to determine the relationship between real exchange rate and FDI flows into Sub-Saharan countries. Alaba (2003) did one of these studies in determining the significance of the relationship that exists between real exchange rate movements and volatility on FDI flows towards certain sectors; manufacturing and agricultural, in Nigeria. Using the Generalized AutoRegressive Conditional Heteroskedasticity (GARCH) model measure of volatility, the error correction methodology being employed for the empirical investigation in testing the effects of both the official and parallel market exchange rates on foreign direct investments flows to manufacturing and agriculture. It is found out that the market exchange rates had a significant effect on FDI flows in agricultural sector than manufacturing. The final conclusion was that as exchange rate fluctuations attracted foreign investment in the agricultural sector, it deterred flows in the
manufacturing sector and hence indicating an aspect of ambiguity on the effects of real exchange rate movements and its sensitivity on foreign direct investment inflows.

In addition, according to findings on this research work, real exchange rates have a negative relationship with the FDI flows that the country receives. This then makes it have a negative significance to the FDI flows. Arbatli (2011), did a research on economic policies and FDI inflows to emerging market economies with the use of autoregressive integrated moving average (ARIMA). The data sample was for 46 countries and the study period was from 1990 to 2009. He found out that real exchange rate appreciation has a negative effect on FDI; however, it was also not significant.

Chakrabarti (2001), also did a study using linear cross-country regressions to search for the determinants of FDI. He used Extreme Bound Analysis (EBA) to examine if any of the conclusions from the existing studies are robust to small changes in the conditioning of information set. The EBA analysis then reveals that there is actually a correlation between FDI flows and exchange rates among other factors. Aw and Tang (2010), did a research on Malaysia on the determinants of inward FDI. They used engle-granger test and OLS method and found out that real exchange rates have a significant impact on FDI flows in the country.

Moreover, Shan (2005); did a study using Vector Autoregression (VAR) approach in determining the relationship between financial development and economic growth, investment, and productivity. The models used a quarterly time-series data from ten OECD countries and China. After due analysis, he later found out that financial development leads to economic growth. That is, real exchange rates as a variable of financial development would then have a significant effect on FDI flows, a part of economic growth item. Ogun et al (2012), who did a study on real exchange rate and FDI in SSA using Granger causality and simultaneous estimation techniques; found out that there is a dependence on real exchange rate movements and FDI flows being received by countries in SSA.

Another researcher, Ogunleye (2008) also had done some study aimed at providing a comprehensive analysis of the exchange rate volatility on FDI in SSA by examining 9 countries in the region. Both country specific time-series and panel model estimation techniques were used. It was then found that exchange rate volatility generally constrains FDI inflows to Sub-Saharan African countries.
The relationship between real exchange rate and FDI flows into Sub-Saharan Africa seem to have different intensities. This is evident from the above studies and even from one Ogunleye (2009); who did a study in Nigeria and South Africa and came to find that in Nigeria there is a significant impact of exchange rate volatility on FDI inflows. That is, exchange volatility retards FDI inflows in Nigeria while a FDI inflow increases exchange rate volatility. But in South Africa, the relationship is insignificant and the reason being an existence of sound capital flows management policy by the Reserve Bank of South Africa.

Therefore, while the study could not clearly reveal a relationship between the two variables in terms of direction of causality for most of the countries; the regression estimates did reveal a pattern of relationship. Also, as depicted by other studies; the level of significance of the relationship between the real exchange rate and the FDI inflows do vary with every country. This could be due to differences in macroeconomic policy implementation processes.
5.4 Conclusion

5.4.1 Effect of Real Interest Rates on FDI flows

In summary, the implications of real interest rates; may be mild or insignificant on the rate of foreign direct investments being received by the country; but what remains clear from the findings is that the effect is of negative significant.

However, for this research work conducted in Kenya over a given period in time; the relationship between real interest rate and foreign direct investment has a negative but weak relationship. This cannot always be ignored in as much as the relationship is a little bit weak.

5.4.2 Effect of Development Expenditure on FDI flows

The finding on the relationship between infrastructure expenditure and foreign direct investment inflows in the country is also mild and weak but bottom line is that the effect is still felt.

The former has a positive effect on the later but at a very small impact. Therefore, in Kenya; the relationship seems to be depicting the above argument; that as the rate of expenditure increases; then it is perceived that the level of infrastructure also improves because more funds is being channeled towards that sector. This then means that FDI inflows will increase gradually.

5.4.3 Effect of Inflation Rate on FDI flows

Furthermore, as to whether the inflation rate of the country has implications on the level of foreign direct investments it receives annually; is still doubtful and may seem insignificant subject to the country being studied by any researcher. What really stands out is that, the country’s inflation rate has a weak relationship with the level of FDI flows it receives on an annual basis. However, the prevailing monetary policies governing the regulation of inflation rates in the country have to take considerations on the above results because it has some tangible effect on the economy as a whole.

Many authors have also come to conclude that in deed inflation rates have an immense effect on the levels of FDI inflows to a country. Therefore, this is the case with the findings that have been gotten from this study on Kenya.
5.4.4 Effect of Real Exchange Rate on FDI flows

The monetary policy committee of the Central Bank of Kenya has always been very instrumental on issues to do with controlling the real exchange rates of the country in order to avoid instances of the Kenyan Shilling depreciating and thereby affecting the economy. This study has then unearthed the implications that real exchange rate has on the level of foreign direct investment that the country receives. The relationship between the two variables is a bit weak but it depicts the reality of the prevailing situation, that suppose the real exchange rates would keep on being high then the level of FDI inflows will continue reducing significantly. A lot more studies done on various countries and regions have confirmed this finding.

Therefore, real exchange rates have negative implications on the level of FDI inflows to the country, Kenya.
5.5 Recommendations

From the above findings and analysis; the following recommendations came up. They include;

5.5.1 Recommendations for Improvement

5.2.1.1 Effects of Real Interest Rates on FDI Inflows

Given the negative though weak relationship between real interest rates and foreign direct investment inflows in the country, recommendations can still be drawn from the findings and analysis. As the government, through CBK, has always intervened by setting an attainable rate called the Central Bank Rate (CBR) to regulate the real interest rates set by the market forces; this is well in line with my recommendation that it should make sure that the financial institutions follow the set threshold within a given range. This monetary policy directive will always check on the cost of borrowing and thereby encouraging for more access to funds and hence more investments in the country.

Also, it is best when the Treasury formulate the most appropriate ways of generating revenue from the economy in order to cut on the budget deficits and avoid sourcing out for more funds from the domestic markets. This can be done through restructuring tax regimes and engaging in projects that generate profits as well as working closely with the private sector in order to find amicable ways of managing funds efficiently. The reason behind this is that; the government will not dominate the domestic funds market in a bid to collect funds and hence crowding out foreign and local investors.

5.2.1.2 Effects of Development Expenditure on FDI Inflows

Given that there exists a positive relationship between infrastructural expenditure and foreign direct investments inflows in the country, recommendations as to this can be made. First, it would be advisable that the government spends more in key infrastructural areas that facilitate trade and investments in the country. The ICT sector is well on course, with the private sector helping in the modernization of all that appertains to it. The transport sector is the main infrastructural set up that should be looked as keenly by the government and this is because it is capital intensive and normally facilitates logistical networks. The government should then concentrate on the key transport networks such the port of Mombasa;
International airports such JKIA (Jomo Kenyatta International Airport) among others; and key link roads in the country.

5.2.1.3 Effects of Inflation Rates on FDI Inflows

There was a negative relationship between the inflation rates in the country and foreign direct investments it receives annually. Inflation rates in the country has been very volatile and erratic in nature and thereby posing significant implications on the level of investments and cost of operating businesses in the country, Kenya. This further affects the level of FDI inflows in the country in the long run. It is therefore suitable for the monetary policy framework be formulated in such a way that prevents large supply of money in the economy as well as weed off the excess money in circulation. This can always be done through reviving the tax regimes and levels and keeping the cost of borrowing at reasonable levels.

5.2.1.4 Effects of Real Exchange Rates on FDI Inflows

The relationship between real exchange rates and foreign direct investments flows in the country is of a negative nature. The findings and analysis of this study confirms so. Also, of late the real exchange rate of the country has been depreciating and therefore, this translates to cutting back of FDI flows in the country. The cost of doing business in the country then becomes high and unbearable and thereby affecting the Balance of Payment (BoP) of the country. This is because the cost of materials and services in the country become expensive as the country currency continues to depreciate. The Central Bank of Kenya has been trying to intervene by pumping in more money to the economy and hence reducing the foreign reserve level of the country. This is a decision that is normally made by the Monetary Policy Committee (MPC). This move is basically short term in nature and that really does not solve the exchange rate issue but contain that problem for a moment.

It is recommended that the country work on ways of supporting indigenous firms, especially those in the EPZ (Export Processing Zone) sector so that they improve on the level of exports and the value of exports too. The government can increase the number of these firms or rather increase on the exports being produced. Full exploitation of key sectors such agricultural and natural resource sectors will help the country improve on export produce. Massive sensitization of Kenyan exports to the international community has to be intensified. This is the only and surest long term solution towards cushioning for exchange rate fluctuations.
5.5.2 Suggestion for Further Studies

Foreign direct investment is currently viewed as a critical source of income towards the economies of many countries, especially in the developing world. Some of the policies that determine the rate of these flows is the macroeconomic policy of the government. The research has then merged the two to find out the implications that will arise. But then it has only covered a few of the critical factors that make up the macroeconomic policy and hence granting for a further research on other factors of the policy and there implications on FDI flows in the country.

Also, the research’s scope if period based and is limited to 2002 to 2013. This also allows for further research on the same topic but on a different timeline in order to test for the deviations that arise from the findings.
REFERENCES


### APPENDICES

#### Appendix 1: Data Collected

**Table A.1:** Data Collected for Macroeconomic Policy Variables and FDI (2002-2013).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>0.21006</td>
<td>2,737,516.45</td>
<td>0.000</td>
<td>78.72975</td>
<td>14.51667</td>
<td>1,891,906.75</td>
<td>13,031,922.49</td>
<td>18.505</td>
</tr>
<tr>
<td>2003</td>
<td>0.54841</td>
<td>7,626,242.74</td>
<td>0.000</td>
<td>75.93833</td>
<td>1.4119318</td>
<td>196,314.52</td>
<td>13,906,020.24</td>
<td>16.365</td>
</tr>
<tr>
<td>2004</td>
<td>0.28619</td>
<td>4,008,762.26</td>
<td>0.000</td>
<td>79.1174</td>
<td>18.245987</td>
<td>2,555,737.99</td>
<td>14,007,123.55</td>
<td>12.532</td>
</tr>
<tr>
<td>2005</td>
<td>0.11320</td>
<td>1,737,601.00</td>
<td>10.117</td>
<td>75.54953</td>
<td>22.761381</td>
<td>3,933,983.73</td>
<td>15,526,227.26</td>
<td>12.687</td>
</tr>
<tr>
<td>2006</td>
<td>0.19622</td>
<td>3,399,113.10</td>
<td>6.417</td>
<td>72.10067</td>
<td>29.203603</td>
<td>5,038,940.74</td>
<td>17,323,002.10</td>
<td>13.636</td>
</tr>
<tr>
<td>2008</td>
<td>0.26629</td>
<td>5,222,984.92</td>
<td>16.231</td>
<td>69.186</td>
<td>51.394816</td>
<td>10,080,478.71</td>
<td>19,613,791.70</td>
<td>11.017</td>
</tr>
<tr>
<td>2009</td>
<td>0.31003</td>
<td>5,659,245.44</td>
<td>9.385</td>
<td>77.352</td>
<td>60.3917504</td>
<td>10,883,506.57</td>
<td>18,021,512.05</td>
<td>11.304</td>
</tr>
<tr>
<td>2010</td>
<td>0.44516</td>
<td>8,287,994.86</td>
<td>3.972</td>
<td>79.233</td>
<td>81.8413593</td>
<td>15,235,608.90</td>
<td>18,615,980.72</td>
<td>14.359</td>
</tr>
<tr>
<td>2011</td>
<td>0.79907</td>
<td>13,865,069.43</td>
<td>13.976</td>
<td>88.8188</td>
<td>85.0641791</td>
<td>14,759,899.79</td>
<td>17,351,486.77</td>
<td>15.049</td>
</tr>
<tr>
<td>2012</td>
<td>0.51378</td>
<td>9,791,992.93</td>
<td>9.640</td>
<td>81.5283</td>
<td>100.1781502</td>
<td>19,092,651.38</td>
<td>19,058,698.27</td>
<td>19.648</td>
</tr>
<tr>
<td>2013</td>
<td>0.93113</td>
<td>18,228,540.92</td>
<td>5.716</td>
<td>86.12283</td>
<td>101.9891667</td>
<td>19,966,102.87</td>
<td>19,576,689.88</td>
<td>17.309</td>
</tr>
</tbody>
</table>

#### Appendix 2: Raw Data (Checklist)

**Table B.1:** Raw Data for Macroeconomic Policy Variables (2002-2013) in Million KShs.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>IF (% of GDP)</th>
<th>EX</th>
<th>RX</th>
<th>DX</th>
<th>Real GDP</th>
<th>Real IR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table B.2: Raw Data for Foreign Direct Investment Variables (2002-2013) in Million KShs.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>F1</th>
<th>F2</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**KEY:**

**IF;** Inflation Rates

**EX;** Exchange Rates

**RX;** Recurrent Expenditure

**DX;** Development Expenditure

**Real GDP;** Real Gross Domestic Product

**Real IR;** Real Interest Rate

**F1;** Foreign Direct Investment Inflows

**F2;** Foreign Direct Investment Outflows