Trade, Market Size, Exchange Rate and Foreign Direct Investment: Co-Integration Analysis for East African Region

Isaya Raphael Mwanyamba

irm@tia.ac.tz
Tanzania Institute of Accountancy
P.O. Box 9522, Dar es salaam, Tanzania.

Abstract

The main objective of this paper is to examine the relationship between Trade, Market size, Exchange rate, and Foreign Direct Investment (FDI) in East African Economic Region. Many studies regarding FDI in this region focused only on individual countries; however, this study employs a different approach from the previous studies by treating East African Region as a single huge market. The Gravity and Mundell's models are employed to present theoretical underpinning and conflicting theoretical and empirical evidence. Regression analysis is done using Vector Error Correction Model. The findings show that trade, market size, and exchange rate have positive and significant influence on inward FDI and the relationship between is long run. It is recommended that EAC should promote favourable terms of trade with the rest of the world, invest in research and development to edify education system that would produce competent workforce, and control exchange rate fluctuation to maintain foreign investors' confidence. Member countries are advised to promote the region as a single foreign direct investment destination rather than each country doing this individually. There is also a need for, transparency on customs' policies among member states.

Key Words: *FDI, Trade, Market Size, REER, Co-integration*

1.0 Introduction

Protagonists for regional economic grouping contend that countries can foster development and growth when they jointly operate as one economy and that economic liberalisation has a positive and significant effect on the foreign direct investment (Rasekhi and Seyedi, 2011). Foreign direct investment (FDI) refers to a commitment in which a firm invests capital in overseas market by creating, managing, and conducting value-adding activities in those countries. It is acknowledged that on the one hand, FDI has been a motivating factor of economic development of host countries, and on the other, the ongoing liberalization of FDI and trade policies lead to an increase in FDI (Feils and Rahman, 2008).

Many of the studies focused on individual countries (Kakar, 2011; Otieno et al, 2013; Shawa, 2014; Mfinanga, 2018) in explaining the role of FDI to economic growth, determinants of FDI and analysing FDI theories on Trade, market size, exchange rate, and their influence on attracting Foreign Direct Investment. There are few studies targeting economic regions and these

mainly focused on North America Free Trade Area (NAFTA) and Middle East and Northern Africa, that is, MENA countries (Brahim and Rachdi, 2014).

Regional economic integration may provide member countries with additional location-specific advantages that can attract multinational enterprises. According to Economic theory by Dunning (1993), nations can upsurge FDI inflows when they function as one gigantic economy because bigger market sizes are very important for attracting more FDIs. East African Community (EAC) as an economic bloc has not been empirically explored in detail to determine the relationship between market size and FDI. East African Community comprises of six member countries, Tanzania, Kenya, Uganda, Rwanda, Burundi and the new member South Sudan that joined in 2016 after acquisition of its independence in 2011. The region covers an area of 2.5 million square kilometres.

This paper carries out an empirical analysis of the relationship between Trade, Market size, Exchange rate, and Foreign Direct Investment. The paper is based in a study, which is inspired by the ongoing treaties within the East African Community economic region with the aim of boosting economic growth and welfare of member states and hence attracting more FDI. East Africa is one of the fastest growing regional economic blocs in the world with a population of not less than 172 million citizens (EAC, no date). Africa including EAC countries experiences a significant decline in FDI inflows from 2014 to 2016 (UNCTAD, 2016). FDI is regarded as an important factor for economic welfare of developing countries therefore because of the importance of the subject under study; the paper addresses macroeconomic factors influencing FDI. The paper is grounded on the theoretical underpinnings of the gravity model, Mundell's model, and the previous researches (e.g. Anyanwu, 2012; Otieno et *al.,* 2013; Tuluce *et al.,* 2016; Mfinanga, 2018). However, a different approach is employed by providing a new way of looking at East Africa as a single market and destination for FDI using continuous data covering a period of 1980 to 2016.

Unlike previous studies, this paper studies this phenomenon in the context of emerging market by assimilating workforce as a control variable. Previous empirical studies (e.g. Daniels, et al., 2009) did not focus on this phenomenon despite their emphasis on the theory

In the current study, hypotheses are developed with reference to relevant literature and then tested to determine the direction of the relationship between capital flow (FDI) and market size, trade openness, exchange rate, and workforce. Two variables are employed as measures for market size of the economy: On the one hand is Gross Domestic Product (GDP). this bases on Krugman and Obstfeld (2006), that there are more FDI inflows among rich countries and that technologically developed, and economically stable countries or regions attract large quantities of FDI in the World (Hasan, 2007). If foreign investors want to sell their products in the host countries, large domestic markets are found to be important (Mfinanga, 2018) Population growth (percentage increase) is also involved as a facilitating factor for market size as explained by Aziz and Makkawi (2012). On the other hand, Masca and Jude (2009) show that FDI depends on consumption and vice versa, and that an increase by 1percent in the final consumption leads to an increase of 0.66percent of FDI stock in the following year. Trade openness is taken as a proxy for trade between EAC and the rest of the world, real effective exchange rate (REER) is employed as a measure for the exchange rate.

The approach employed in the current study differs from the one employed in a study by Otieno et al. (2013) in that, instead of using panel data that present each economy of East African Community, the region is treated as one whole economy using time series data for a period of 37 years (1980-2016). This would give a clear picture of the influence of trade, market size, and exchange rate of the economic region on the inward FDI.

Workforce was found to be ae bottleneck for FDI inflow to East African Community; for it was found to affect significantly the FDI negatively. The size of the economy and the cost of capital were found to have an impact on inflows of FDI in the East African Community. Finally, the paper ends with policy recommendation basing on the findings, suggestions for new research agenda for East African Community toward Economic integration and FDI attraction are provided emphasising on issues such as cultural and institutional differences between member states.

1.1 Trends of FDI in recent years

Global FDI inflows in recent years

The world experienced a sharp rise of FDI in 2015; however, according to UNCTAD World Investment report of 2017, global FDI flows lost growth thrust in 2016, implying that the road to recapture growth remains rough. FDI inflows decreased by 2 per cent to $1.75 trillion, amid weak economic growth and significant policy risks, as perceived by multinational enterprises (MNEs). FDI flows to developing Asia contracted by 15 percent to $443 billion in 2016. FDI flows to FDI in structurally weak and vulnerable economies remained fragile. Flows to the least developed countries fell by 13 per cent, to $38 billion (UNCTAD, 2017).

FDI inflows to Africa

According to UNCTAD (2017), FDI inflows to Africa accounted for between 2.8 and 4.4 percent of the world's total, while FDI outflows were not more than 0.5 percent. The flows to Africa turned increased from $0.1 billion in 2015 to -$1.3 billion in 2016. Angola remained by far the largest FDI host in LDCs, hosting nearly 40 percent of the total foreign investment flows to the group. However, inward FDI declined for the second consecutive year from a record of $17 billion posted in 2014 to $14 billion (-11 %). FDI flows to Sudan, another oil-related economy, fell to $1 billion (-38 per cent), as opposed to the peak of over $2 billion in 2012. Northern Africa has been the top destination for FDI in Africa. South Africa shows a difference in FDI inflows from the rest of African countries, in that while in other countries large percentage of FDI goes to natural resources; much of foreign direct investment in South Africa goes to the manufacturing sector.

Middle Africa has been the second FDI destination over the previous years. However, macroeconomic instability and poor investment promotion strategies have been responsible for the declining FDI trend in the African region (Dupasquie and Osakwe, 2003). Two leading mineral exporters – the Democratic Republic of Congo and Zambia – also experienced a further shrinking of their FDI in the face of low commodity prices. In the case of the former, despite the growing interest from Chinese firms, FDI fell for the fourth consecutive year to $1 billion (-28 percent), which was significantly below its 2012 peak of more than $3 billion. Ethiopia recorded

a strong growth in FDI (up 46 percent to $3 billion) and became the second largest LDC host economy, up from the fifth position in 2015.

FDI inflows to East African Countries

According to the United Nation Conference on Trade and Development (2017), inward FDI in The United Republic of Tanzania, which is also expected to become a new producer of natural gas in the future, slipped to $1.4 billion (-15 per cent) for the third consecutive year because of uncertainties on FDI policies and tax rules (UNCTAD, 2017). The FDI to Kenya continued weakening and collapsed by 36 per cent to $394 million in 2016 – only slightly more than a quarter of her 2011 level. This happened despite investment reforms and a supportive domestic policy environment. FDI inflow to Uganda dropped from $1057 million in 2014 to $738 million in 2015 and dropped further to $626 million in 2016. However, inflows to Burundi increased from $65.1 million to $146 million, while FDI in Rwanda dropped in three consecutive years from $459, $380, and $342 million in 2014, 2015, and 2016 respectively. The same report shows that East Africa's foreign direct investments inflows declined by 25.3 percent to $6.6 billion, down from $8.8 billion in 2016, Kenya recorded the highest decline in FDI inflows, followed by Uganda.

2.0 Literature Review

2.1 Theoretical Literature Review

The Gravity Model

The gravity model of trade in international economics similar to other gravity models in social science predicts bilateral trade flows based on the economic sizes of (often using GDP measurements), and distance between the two units. The model was first used by Tinbergen (1962). The basic theoretical model for trade between two countries (i and j) takes the form of:

$$F_{ij} = G \frac{M_i M_j}{D_{ij}}$$

Where F_{ij} is the trade flow between two trading partners, Mi and M_j are the economic masses of each country (also can be capital flow), D is the distance, and G is a constant. This model has also been utilised in international affairs to appraise the impact of treaties and alliances on trade, and to test the efficiency of trade agreements and organizations such as the North American Free Trade Agreement (NAFTA), Southern Africa Development (SADC), and the World Trade Organization (WTO). Some studies used a variety of cost related variable as an alternative to distance to imply cost of doing business. As Asafo (2007) argues, the gravity model goes beyond the idea of such model to take advantage of the size of the economies concerned and their distance (cost of doing business). The cost of doing business may also be reflected by the risk in the macroeconomic environment of the recipient economy for FDI. As is the case in this study, poor infrastructure may be a discouraging factor to foreign investors for it increases distance in the form of the cost of doing business.

The Mundell's Model

This model enlightened the notion of FDI using Neo-Classical context, the model postulates that FDI is the outcome of restriction of merchandise trade. The theory argues, that prices equalisation is the consequence of movement of capital across nations; and that capital is exported by capital-abundant nations until the returns are equalised. The same idea applies to

trade barriers as a motivating factor for FDI, and that countries restricting capital mobility will increase trade flows. For this reason, Mundell's ides treat trade and investment as substitutes. This concept fails to explain the role of local investment in attracting more FDI.

2.2 Empirical Literature Review

Some empirical studies on trade and FDI proved wrong the Mundell's (1957) theory, which claims that trade barriers influence capital flows among nations. Trade liberalisation and increasing internationalisation of business firms resulted in more FDI than before. Scholars, (e.g. Onyeiwu and Shrestha, 2004; Anyanwu, 2012), revealed that openness has significant influence on FDI and that the increase in trade openness causes more FDI to flow into African countries. Similarly, Maku (2015) found that openness to trade has attracted FDI significantly, as it caused an increase on FDI inflows by 3.2 percent.

The impact of regional economic integration on investment is a predetermined conditioned by inherited policies, as well as by the prevailing macroeconomic situations (Blomström *et al.,* 1998). As Jordaan (2004) observes, FDI will transfer to nations with greater and expanding markets and larger purchasing power, where businesses can possibly obtain higher returns on their capital and by implication receive higher profits from their investments. Market size in the form of GDP has been proved to have a strong causal relation with FDI even for individual countries (Kakar and Khilji, 2011). According to Mfinanga (2018), small market size discourages the inflow of foreign direct investment.

Applying Generalised Least Squares, Otieno *et al.,* (2013) found that Regional Integration has no positive impact on FDI. However, they recommended that East African countries should also maintain financial stability so that investors can have the confidence in their expected future profits. In order to attract higher amounts of FDI, developing countries should stress regional economic integration, or at least, they should make regional trade agreements or free trade agreements (Tuluce *et al., 2016*). Brooks and Sumulong (2003), in their studies on the policy context on the occurrence of FDI flows found that a favourable policy framework for FDI generally provides economic stability, transparent rules on entry and operations, equitable standards of treatment between domestic and foreign firms and secures the proper functioning and structure of the markets.

Using pooled cross-sectional, time-series regressions; Feils and Rahman (2008) ascertain that NAFTA has had a positive effect on FDI inflows into the region though not all countries benefited equally. Empirical evidence suggests that policies encouraging domestic investment help to attract international investment. Anyanwu, (2012) analysed factors that influence FDI inflows in Africa and found that market size, trade, rule of law, foreign aid, natural resources, and past FDI inflows have a positive effect on FDI inflows. Wadhwa and Reddy (2011) pointed out that GDP is an important factor for market seeking FDIs rather than resource seeking FDI. Aziz and Makkawi (2012) found that large population size influences spending power.

Moreover, Lily *et al.,* (2014) found that stable exchange rate and appreciation of currencies have a positive impact on FDI, and depreciation of the value currencies affect FDI negatively in the Asean economies. However, later on Mfinanga (2018) found that the fluctuated exchange rate

policy adopted by the countries could increase the inflow of foreign direct investment in the country. A study by Deseatnicov and Akiba (2016) clearly demonstrate that multinational enterprises are less tolerant to the exchange rate risk. Phillips and Ahmad-Esfahani (2008) pointed out that there is no consensus about the nature of the relationship between exchange rate and FDI in either the theoretical or the empirical work. Studies provide varying findings on the relationship between FDI and Exchange rate, for example; foreign direct investment from Japan and the United States to the Southeast Asian countries is considerably affected by bilateral real exchange rates (Goldberg and Klein, 1997).

2.3 Hypotheses

Hypothesis 1*: There is positive relationship between trade openness and FDI*

Hypothesis 2*: There is a positive relationship between GDP and Foreign Direct Investment (FDI).*

Hypothesis 3*: There is a positive relationship between population growth and Foreign Direct Investment (FDI).*

Hypothesis 4*: There is a positive/negative relationship between Real exchange rate and inward FDI in the EAC.*

Hypothesis 5*: There is a positive/negative relationship between workforce and FDI.*

3.0 Methodology

3.1 The Empirical Model

In this paper, the following empirical model is proposed for Trade (TRADE), Market size (GDP and Population) and exchange rate as independent variables, in ward Foreign Direct Investment (FDI) as a dependent variable, and Workforce as a control variable; large GDP and Population reflect higher demand for goods and services. The size of the population may not be ignored by MNEs as they seek to increase their profits in the international markets (Kilgore *et al.,* 2007). This is a reason why population is considered as a necessary variable in the analysis.

$$FDI = f(TRADE, GDP, POP, REER \text{ and } WF) \quad \ldots\ldots (1)$$

Therefore, our linear empirical model for the analysis becomes:

$$FDI = \beta_o + \beta_1 TRADE + \beta_2 GDP + \beta_3 POP + \beta_4 REER + \beta_5 WF + Y_t \quad \ldots\ldots (2)$$

Whereas:

FDI = total FDI inflows in East African region in million USD. TRADE = Trade openness, that is, Total export and import as percentage of GDP. GDP = Real Gross Domestic Product in million USD. POP = Average East Africa urban population as the percentage of East Africa total Population, forming a bigger part of consumers for industrial products and services. REER = Real Exchange Rate (Volatility of exchange rate in East African Region). WF = Average East Africa labour force as the percentage of the total regional population. β_0 is a constant and Y_t is an error term representing other variables that influence the inflow of FDI in the region, but are not integrated in the model, and β_1 to β_5 are the corresponding coefficients of the independent variables.

3.2 Data Collection and Data Sources

All data used in this analysis are secondary. The researcher employed time series data covering the period of 36 years, from year 1980 to 2016. Data were collected from UNCTAD Statistics

online database; this source was specifically selected because it is relied upon and recognised worldwide as a steady source of macro data.

3.3 Data processing and Analysis

This paper employs quantitative time series data, which were analysed using statistical packages, Stata, OLS regression and the results are shown in Table 3.1.

Table 3.1 Results of OLS regression

Dependent variable= FDI				
Variable	Coefficient	Standard error	t-statistics	Probability
C	7368.161	3091.522	2.38**	0.024
TRADE	0.9782054	3.586229	0.27	0.787
GDP	0.004683	0.001563	2.60**	0.015
POP	0.0075804	0.0045488	1.67	0.107
REER	7.947813	2.476415	3.21***	0.003
WF	-183.5892	67.13809	-2.73***	0.011
R-squared = 0.9721, Adjusted R-squared = 0.9671, Probability (F-Statistic) = 0.0000		Durbin-Watson Statistic (original) = 2.4 Breusch-Pagan / Cook-Weisberg test = chi2(1) = 1.91 Prob > chi2 = 0.8623		

***Source**: Author's computation from data analysis (2018)*

After OLS regression, the following tests were applied; Phillip and Perron Unit Root Test (to measure order of integration) and Johansen Test for co-integration (to measure the long run/short run relationship between variables), and finally, Error Correction Model (VECM) was applied. The value of Durbin-Watson Statistics shows the availability of autocorrelation, and Breusch-Pagan/Cook-Wesberg test shows the presence of heteroscedasticity. Therefore, the results of OLS regression will not be blue; this calls for further tests that are presented in part 4.0.

4.0 Findings

4.1 Unit Root Test

Time series regression desires data, which are stationary (data that have no unit root). Data were tested using Phillip Perron (PP) unit root test. PP tests the order of integration of the variables. Regressing data that are non-stationary would more than likely yield to incorrect results because their means change over time.

Null hypothesis: At levels, data are not stationery that is, they have unit root

After carrying the PP Unit root test at levels as presented in Table 4.1, all the variables were not stationary implying that we could not reject the null hypothesis of the presence of unit root at levels. Therefore, the unit root test was further performed at first difference and the results are shown in Table 4.2.

Null hypothesis: at first difference, all data are not stationary, or have unit roots.

Table 4.1 Unit root test at levels

VARIABLE	PP Test statistics	Order of integration
FDI	1.608	I(1)
GDP	4.331	I(1)
TRADE	-0.760	I(1)
RER	1.181	I(1)
POP	1.904	I(1)
WF	-1.706	I(1)

Source: *Author's computation derived from data analysis (2018)*

Note:

(i) McKinnon (1991) critical values are used to reject the null hypothesis of the unit root
(ii) I (0) means the variable is stationery
(iii) I (1) means the variable is integrated at order one
(iv) Critical values for PP are *** 1% = -3.696, **5% = -2.978, *10% = -2.620

Table 4.2 Unit Root Test at first difference

VARIABLES	PP Test statistics	Order of integration
FDI	-5.301	I(0)***
GDP	-3.284	I(0)**
TRADE	-5.112	I(0)***
RER	-4.949	I(0)***
POP	-5.974	I(0)***
WF	-12.217	I(0)***

Source: *Author's computation derived from data analysis (2018)*

Note:

(i) McKinnon (1991) critical values are used to reject the null hypothesis of the unit root
(ii) I (0) means the variable is stationery
(iii) 1 (1) means the variable is integrated at order one
(iv) Critical values for PP are *** 1% = -3.702 and **5% = -2.980

Regarding the results in Table 4.2, at first difference, all variables rejected the null hypothesis of the existence of unit root at 1 percent level (for FDI, TRADE, POP, RER, and WF), and at 5 percent level for GDP. Consequently, at first difference, all variables were stationery.

4.2 Johansen Co-integration Test

The Johansen test for co-integration was performed and the results are shown in table 4.3.
Null hypothesis: There is no co-integration among the variables.

The results show that there is co- integration among the variables, the null hypothesis of no co-integration is rejected; that is to say, the variables in our regression model have long run relationship; hence, a Vector Error Correction Model can be employed to determine the level of influence of the independent variables relative to dependent variable.

Table 4.3 Johansen tests for Co-integration

Rank	Trace statistics	5% critical value
0	165.5328	104.94
1	102.1351	77.74
2	63.7414	54.64
3	29.9769*	34.55
4	13.3257	18.17
5	2.8478	3.74

Source: *Author's computation from data analysis (2018)*

4.4 Error Correction Model

Error correction model was introduced to incorporate the error term. The error term accounted for other variables that would have influence on the dependent variable but were not included in our empirical model; therefore, equation 2 became.

$$FDI = \beta_o + \beta_1 DTRADE + \beta_2 DGDP + \beta_3 DPOP + \beta_4 DRER + \beta_5 DWF + L\_ECT \quad \text{(3)}$$

Note: L_ECT = the variable generated to account for an error term. A letter D means that the variables were stationary at first difference. Equation 3 is the one that was considered for VECM regression of the preferred model. The results for VECM analysis are presented in Table 4.4.

Table 4.4 Vector Error Correction Model Results

	Dependent variable= FDI			
Variable	Coefficient	Standard error	t-statistics	Probability
C	27532.87	6335.385	4.35***	0.000
TRADE (-1)	19.53893	4.236462	4.61***	0.000
TRADE (-2)	20.75089	5.39574	3.85***	0.000
TRADE (-3)	35.281	5.049715	6.99***	0.000
GDP (-1)	.0084601	.006328	1.34	0.181
GDP (-2)	.0039482	.0068845	0.57	0.566
GDP (-3)	.0403242	.0053875	7.48***	0.000
POP (-1)	41.81336	1.820078	22.97***	0.000
POP (-2)	0	7.724064	0.00	1.000
POP (-3)	31.45383	6.015252	5.23***	0.000
REER (-1)	18.58497	1.86665	9.96***	0.000
REER (-2)	24.01682	2.228643	10.78***	0.000
REER (-3)	17.9092	2.938853	6.09***	0.000
WF (-1)	-337.1856	63.78735	-5.29***	0.000
WF (-2)	-385.1711	82.82428	-4.65***	0.000
WF (-3)	-297.6363	66.08409	-4.50***	0.000
R-squared = 0.9721		Probability (F-Statistic) = 0.0000		
Adjusted R-squared = 0.9671		Durbin-Watson Statistic = 2.04		

Source: *Author's computation from data analysis (2017)*

**** Significant at 1% level, ** significant at 5% level*

4.5 Interpretation and discussion of findings

From the results of Vector Error Correction Model (VECM), TRADE was found to have a positive and significant impact on FDI as lagged 1 up to 3 FDI showed significant positive influence on FDI. This implies that trade relationship between East Africa and the rest of the world influences foreigners to come and invest in the region. Among all variables, TRADE appeared to be the most influential predictor of FDI in East Africa; the increase in trade between the region and the rest of the world improves her competitiveness and hence attracts more foreign investors. Lagged 1 and lagged 2

GDP has a positive relationship with FDI, though the relationship is not significant, lagged 3. GDP was found to be positive and significant at 1 percent level, meaning that leaving other factors constant more than 95 percent of FDI inflows in East Africa is explained by the growth in GDP. Therefore, economic growth has a positive and significant impact on inward foreign investment. The insignificance of lagged 1 and 2 GDP is a prediction that a decline in EAC regional GDP would have an unfavourable impact on FDI.

On the other hand, lagged 1and 3 REER was found to have positive and significant influence on FDI at 1 percent level. This shows that a decrease in the cost of obtaining domestic currency has a great impact on FDI in the region, because it becomes easy for foreign investors to buy domestic currency and invest. This is a reflection of the cost of capital; the lower the capital the more the investors are encouraged to operate in the East African Community. Population (POP) was found to have a positive and significant relationship with FDI. Population also reflects the size of the market, the higher the population the greater the demand for goods and services. Therefore, EAC with the total population of about 150 million people provides a potential large market that encourages inflow of market driven FDIs.

East African workforce was found to have a negative and significant relationship with FDI, an increase in the workforce causes FDI to decrease significantly. This implies that majority of the workforce in East Africa is unproductive because it is unskilled, and therefore it discourages investors who desire great returns from their investment. Many graduates in East Africa lack practical skills and creativity (Andrews, 2016) in running businesses, thus foreign investors are not attracted with East African labour market. In this paper, we found that regional integration could have a very important effect on foreign direct investment. This suggests that a move towards Regional Integration of East Africa would strengthen considerably FDI inflows to the region, given the difference in relative endowments and the recent trend to reduce trade barriers in many countries within East Africa Community.

4.6 Conclusion and Recommendations

4.6.1 Conclusion

In this paper the relationship between Trade, Gross Domestic Product (GDP) and population as proxies for market size, Real exchange rate as a measure of cost of capital, and Workforce were analysed. Time Series Data of 1980 to 2016 were tested using Unit root test then analysed by applying Co-integration Test and Vector Error Correction Model. Trade, Market size, and exchange rate are positively related to FDI inflow and the relationship is significant. Therefore, the findings have shown that the size of the economy matters in attracting FDIs. Workforce was found to be negatively related to FDI.

4.6.2 Policy Recommendations

East Africa as a region must assess all other significant factors for macroeconomic improvement such as trade openness, including maintaining macroeconomic stability, equitable resource distribution, and current account steadiness by avoiding unfavourable terms of trade. Regional Integration member countries should promote and improve factors responsible for GDP growth such as investment by offering credit and subsidies to private sector. This would create suitable environment for doing business and hence attract more FDI. Harmonization of rules and regulation concerning taxation and investment should be taken into consideration. Member states need to exercise transparency in tax exemption and other fiscal related policies.

The East Africa Community has to continue deliberately in investing in the area of Research and Development (R&D) to improve formal education and vocational training education to produce competent workforce capable of taking managerial positions in business enterprises. The EAC bloc needs to build capacity of its people (citizens) through seminars, workshops, trainings and support its population to take part in various levels of production and processes of different materials, which are attractive to FDIs home countries. Member countries are required to promote the region as a single foreign investment destination instead of every country promoting her foreign investment individually. Stability of exchange rates should be sustained from adverse fluctuation. Further research on the subject is also recommended in the region to include the impact of cultural and institutional differences on FDI among the member states.

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