UNIVERSITI PUTRA MALAYSIA

RELATIONSHIPS BETWEEN ECONOMIC GROWTH, FOREIGN DIRECT INVESTMENT, AND POVERTY IN AFRICA

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RELATIONSHIPS BETWEEN ECONOMIC GROWTH, FOREIGN DIRECT INVESTMENT, AND POVERTY IN AFRICA

By

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Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia, in Fulfillment of the Requirements for the Degree of Doctor of Philosophy

February 2017
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Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirement for the Degree of Doctor of Philosophy

RELATIONSHIPS BETWEEN ECONOMIC GROWTH, FOREIGN DIRECT INVESTMENT, AND POVERTY IN AFRICA

By

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February 2017

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In the past years, Africa has experienced fast economic growth, unimproved business environment, low foreign direct investment inflows, and continuous high poverty rate. In fact, foreign direct investment (FDI) inflows in Africa are the lowest compared to other region's FDI inflows. Moreover, African countries are ranked at the bottom of the country-ranking list in term of quality of business environment. Therefore, the objectives of this study are to investigate the impact of foreign direct investment on economic growth in Africa, to estimate the impact of business environment on foreign direct investment, and to examine the determinants of poverty in the continent. The study covers the period from 2000 to 2014 in 50 African countries. The study utilizes panel annual data from World Bank, Mo Ibrahim Foundation, and United Nation Development Program. The study uses system Dynamic Generalized Method of Moments estimator (DGMM) because it takes control of endogeneity, and country specific effects problems that may arise in panel data estimations. The study found that foreign direct investment and business environment in addition to human capital, financial development, and political stability significantly contribute to economic growth of African countries. In addition, the results of the study reveal that business environment, economic growth, financial development, and institutions quality have important role in attracting the FDI inflows into African countries. Moreover, the study found that an improvement in economic growth, foreign aid, trade, and political stability significantly reduce poverty rate in the region. Overall results provide empirical evidence for African policy-makers to introduce policies that aim to attract more FDI inflows to enhance the economic growth of the region. Also, the results delivers empirical evidences for policy-makers to improve business environment that attracts more FDI inflows which
generates economic growth. It also provides strong evidence for policy-makers to improve financial services to facilitate trade and doing business in the continent. In addition, this study provides better foundation for African policy-makers to manage and introduce effective policies that would help in generating more economic growth and reduce poverty rate in Africa. Finally, this study has achieved the objectives of the thesis.
Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk Ijazah Doktor Falsafah

HUBUNGAN ANTARA PERTUMBUHAN EKONOMI, PELABURAN LANGSUNG ASING, DAN KEMISKINAN DI AFRIKA

Oleh

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Afrika untuk memperkenalkan dasar-dasar yang bertujuan untuk menarik aliran masuk FDI untuk meningkatkan pertumbuhan ekonomi di rantau ini. Juga, keputusan menyampaikan bukti-bukti empirikal untuk pembuat dasar untuk menambah baik persekitaran perniagaan yang menarik aliran masuk FDI. Ia juga menyediakan bukti yang kukuh untuk pembuat dasar untuk meningkatkan persekitaran perniagaan yang menarik aliran masuk FDI. Ia juga menyediakan bukti yang kukuh untuk pembuat dasar untuk meningkatkan perkhidmatan kewangan dan memudahkan perdagangan dan menjalankan perniagaan di benua itu. Di samping itu, kajian ini menyediakan asas yang lebih baik untuk pembuat dasar Afrika untuk mengurus dan memperkenalkan dasar-dasar yang berkesan yang akan membantu pertumbuhan ekonomi dan mengurangkan kadar kemiskinan di Afrika. Akhir sekali, kajian ini telah mencapai objektif tesis.
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Last but not the least; I would like to thank my family: my mother, my sisters, and my wife for supporting me spiritually throughout writing this thesis and in my life in general.
I certify that a Thesis Examination Committee has met on 17 February 2017 to conduct the final examination of Abdelbagi Edrees Saied Edrees on his thesis entitled "Relationships between Economic Growth, Foreign Direct Investment and Poverty in Africa" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Doctor of Philosophy.

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Declaration by graduate student

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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABSTRACT</td>
<td>i</td>
</tr>
<tr>
<td>ABSTRAKT</td>
<td>iii</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>v</td>
</tr>
<tr>
<td>APPROVAL</td>
<td>vi</td>
</tr>
<tr>
<td>DECLARATION</td>
<td>viii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xii</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xiv</td>
</tr>
</tbody>
</table>

## CHAPTER

### 1 INTRODUCTION

1.1 Background 1
1.2 African Economy 2
1.3 Foreign Direct Investment (FDI) in Africa 8
1.4 Business Environment in Africa 15
1.5 Poverty in Africa 23
1.6 Problem Statement 25
1.7 Objectives 27
1.8 Significance of the Study 27

### 2 LITERATURE REVIEW

2.1 Introduction 29
2.2 FDI and Economic Growth 29
   2.2.1 Theoretical Literature 29
   2.2.2 Empirical Literature 31
2.3 Business Environment and FDI 39
   2.3.1 Theoretical Literature 39
   2.3.2 Empirical Literature 42
2.4 Determinants of Poverty 52
   2.4.1 Theoretical Literature 52
   2.4.2 Empirical Literature 53
2.5 Summary 61

### 3 METHODOLOGY

3.1 Introduction 62
3.2 Methodology 62
3.3 Empirical Models 64
   3.3.1 Empirical Model for Objective One 64
   3.3.2 Empirical Model of Objective Two 67
   3.3.3 Empirical Model of Objective Three 68
3.4 Variables, Measurement and Data Sources 70
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td><strong>EMPIRICAL RESULTS AND DISCUSSIONS</strong></td>
<td>73</td>
</tr>
<tr>
<td></td>
<td>4.1 Introduction</td>
<td>73</td>
</tr>
<tr>
<td></td>
<td>4.2 Impact of FDI and Business Environment on Economic Growth</td>
<td>73</td>
</tr>
<tr>
<td></td>
<td>4.3 Impact of Business Environment on FDI</td>
<td>88</td>
</tr>
<tr>
<td></td>
<td>4.4 Determinants of Poverty</td>
<td>104</td>
</tr>
<tr>
<td></td>
<td>4.5 Summary</td>
<td>123</td>
</tr>
<tr>
<td>5</td>
<td><strong>CONCLUSION AND POLICY IMPLICATIONS</strong></td>
<td>125</td>
</tr>
<tr>
<td></td>
<td>5.1 Introduction</td>
<td>125</td>
</tr>
<tr>
<td></td>
<td>5.2 Contributions of the Study</td>
<td>125</td>
</tr>
<tr>
<td></td>
<td>5.3 Policy Implications</td>
<td>126</td>
</tr>
<tr>
<td></td>
<td>5.4 Suggestions for Future Research</td>
<td>127</td>
</tr>
<tr>
<td></td>
<td>5.5 Concluding Remarks</td>
<td>127</td>
</tr>
<tr>
<td></td>
<td><strong>REFERENCES</strong></td>
<td>129</td>
</tr>
<tr>
<td></td>
<td><strong>APPENDICES</strong></td>
<td>155</td>
</tr>
<tr>
<td></td>
<td><strong>BIODATA OF STUDENT</strong></td>
<td>156</td>
</tr>
<tr>
<td></td>
<td><strong>LIST OF PUBLICATIONS</strong></td>
<td>157</td>
</tr>
</tbody>
</table>
## LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Data description</td>
<td>71</td>
</tr>
<tr>
<td>4.1</td>
<td>Impact of FDI on Economic Growth (Descriptive Statistics)</td>
<td>74</td>
</tr>
<tr>
<td>4.2</td>
<td>Impact of FDI on Economic Growth (Correlation Mareix)</td>
<td>75</td>
</tr>
<tr>
<td>4.3</td>
<td>Impact of FDI on Economic Growth (Results of System GMM One-Step)</td>
<td>76</td>
</tr>
<tr>
<td>4.4</td>
<td>Impact of FDI on Economic Growth (Results of Difference GMM One-Step)</td>
<td>78</td>
</tr>
<tr>
<td>4.5</td>
<td>Impact of FDI on Economic Growth (Results of Difference GMM Two-Step)</td>
<td>79</td>
</tr>
<tr>
<td>4.6</td>
<td>Impact of FDI on Economic Growth (Results of System GMM Two-Step)</td>
<td>81</td>
</tr>
<tr>
<td>4.7</td>
<td>Impact of FDI on Economic Growth (Results of System GMM Two-Step)</td>
<td>82</td>
</tr>
<tr>
<td>4.8</td>
<td>Impact of FDI on Economic Growth (Sensitivity Analysis)</td>
<td>83</td>
</tr>
<tr>
<td>4.9</td>
<td>Impact of Business Environment on FDI (Descriptive Statistics)</td>
<td>89</td>
</tr>
<tr>
<td>4.10</td>
<td>Impact of Business Environment on FDI (Correlation Matrix)</td>
<td>89</td>
</tr>
<tr>
<td>4.11</td>
<td>Impact of Business Environment on FDI (Results of System GMM One-Step)</td>
<td>91</td>
</tr>
<tr>
<td>4.12</td>
<td>Impact of Business Environment on FDI (Results of Difference GMM One-Step)</td>
<td>93</td>
</tr>
<tr>
<td>4.13</td>
<td>Impact of Business Environment on FDI (Results of Difference GMM Two-Step)</td>
<td>94</td>
</tr>
<tr>
<td>4.14</td>
<td>Impact of Business Environment on FDI (Results of System GMM Two-Step)</td>
<td>96</td>
</tr>
<tr>
<td>Section</td>
<td>Title</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>4.15</td>
<td>Impact of Business Environment on FDI (Results of System GMM Two-Step)</td>
<td>97</td>
</tr>
<tr>
<td>4.16</td>
<td>Impact of Business Environment on FDI (Sensitivity Analysis)</td>
<td>99</td>
</tr>
<tr>
<td>4.17</td>
<td>Determinants of Poverty (Descriptive Statistics)</td>
<td>105</td>
</tr>
<tr>
<td>4.18</td>
<td>Determinants of Poverty (Correlation Matrix)</td>
<td>105</td>
</tr>
<tr>
<td>4.19</td>
<td>Determinants of Poverty (Results of System GMM One-Step)</td>
<td>106</td>
</tr>
<tr>
<td>4.20</td>
<td>Determinants of Poverty (Results of Difference GMM One-Step)</td>
<td>107</td>
</tr>
<tr>
<td>4.21</td>
<td>Determinants of Poverty (Results of Difference GMM Two-Step)</td>
<td>108</td>
</tr>
<tr>
<td>4.22</td>
<td>Determinants of Poverty (Results of System GMM Two-Step)</td>
<td>110</td>
</tr>
<tr>
<td>4.23</td>
<td>Determinants of Poverty (Results of System GMM Two-Step)</td>
<td>112</td>
</tr>
<tr>
<td>4.24</td>
<td>Determinants of Poverty (Results of System GMM Two-Step)</td>
<td>114</td>
</tr>
<tr>
<td>4.25</td>
<td>Determinants of Poverty (Results of System GMM Two-Step)</td>
<td>115</td>
</tr>
<tr>
<td>4.26</td>
<td>Determinants of Poverty (Sensitivity Analysis)</td>
<td>117</td>
</tr>
</tbody>
</table>
# LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Map of Africa</td>
</tr>
<tr>
<td>1.2</td>
<td>Economic Growth</td>
</tr>
<tr>
<td>1.3</td>
<td>Trade as a Percentage of GDP</td>
</tr>
<tr>
<td>1.4</td>
<td>FDI Inflows</td>
</tr>
<tr>
<td>1.5</td>
<td>FDI Inflows in Africa</td>
</tr>
<tr>
<td>1.6</td>
<td>FDI and Growth in Africa</td>
</tr>
<tr>
<td>1.7</td>
<td>Financial Development and FDI in Africa</td>
</tr>
<tr>
<td>1.8</td>
<td>Ease of Doing Business</td>
</tr>
<tr>
<td>1.9</td>
<td>Countries Ranking, Ease of Doing Business</td>
</tr>
<tr>
<td>1.10</td>
<td>Business Environment and Growth in Africa</td>
</tr>
<tr>
<td>1.11</td>
<td>Business Environment and FDI in Africa</td>
</tr>
<tr>
<td>1.12</td>
<td>Ibrahim Index Components</td>
</tr>
<tr>
<td>1.13</td>
<td>Growth and Poverty in Africa</td>
</tr>
<tr>
<td>1.14</td>
<td>FDI and Poverty in Africa</td>
</tr>
<tr>
<td>4.1</td>
<td>FDI Inflows in Africa</td>
</tr>
<tr>
<td>4.2</td>
<td>Human Development</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

1.1 Background

Africa is the second-largest continent in the world, which covers about 30.2 million kilo-meter² including the islands that nearby the region. Africa covers about 6% of the total surface area of the planet and almost 20.5% of the land area in the world. The continent is the second-most-populous continent in the world, as at 2014, African population was about 1.1 billion that almost exceeds 15% of the total population in the world. The Mediterranean Sea is surrounding Africa in the north, while the continent is bordered by the Suez Canal and the Red Sea in the northeast. The Indian Ocean enclosed Africa in the southeast, while the region is surrounded by the Atlantic Ocean in the west.

Africa has 54 known countries (independent states), nine regions and two de facto sovereign countries with partial or no recognition. All borders of African countries have been drawn during the era of European colonization. Population in Africa has significantly grown over the past years which results in a mainly young population. African population has noticeably increased from 221 million in 1950 to about 1 billion or more as at 2014. In fact, population in Africa is the youngest among all other regions and in the world. For instance, most of Africans are aging below 19 years old or much younger. The largest country by area in Africa is Algeria while Nigeria is the largest one in Africa by population (African Union, 2015).

The African Union (AU) is a 54-member association comprising of all of Africa’s countries. The union was formed in 2001 in Ethiopia as its center of operations. The union formally established on July 2002 as a replacement of the Organization of African Unity (OAU). In July 2004, the African Union’s Pan-African Parliament (PAP) was moved to South Africa (Midrand), but the African Commission on Human and Peoples’ Rights continued to be in Ethiopia (Addis Ababa). The reason behind centralizing the African Federation’s institutions is to be available to all African countries so that all member-states can access and share the information.

The African Union is designed by the Constitutive Act of the African Union, which targets to renovate the African Economic Community, a joined commonwealth, into a formal under recognized international
conventions. The African Union has a senatorial government, which
known as African Union Government, consisting of legislative, judicial
and executive organs. The authority and power of the Head of the
African Union Government derived from the Constitutive Act and

Figure 1.1: Map of Africa

1.2 African Economy

In the past ten years, African economic growth has exceeded the one
that achieved by East Asia. The World Bank (2015) reported that some
of African countries are now go through fast economic growth. The
reasons behind this fast growth are the natural resources, increased
political stability, and the sustained peacefulness in those countries.
According to the World Bank 2015, recent economic growth in Sub-
Saharan African countries is surpassed the world growth rate.
During the past years, most of African countries have experienced noticeable and fast economic growth that exceeded the global growth rate. For instance, in 2011, the top economies in Africa that achieved high economic growth are Mauritania at 19.8%, Angola at 17.6%, Sudan at 9.6%, and Malawi at 7.8%. The other countries that experienced fast growth include Rwanda, Chad, Burkina Faso, and Ethiopia. The fast economic growth in African countries has attracted many international agencies to invest in those emerging African economies. Despite the international economic depression, African countries continued achieving high economic growth which makes investment returns in a high return rate amongst all developing countries (World Bank, 2015).

The African economy consists of trade, agriculture, industry, and human resources of the region. Recent economic growth was a result of growth in manufacturing and sale of commodities and services. In terms of resource, Africa is a resource rich continent; however, many African people are extremely poor. According to the World Bank, as at March 2013, Africa was the world’s poorest continent. However, the World Bank expects that most African countries will reach “middle income” status (defined as at least US$1,000 per person a year) by 2025 if the current economic growth rates continued (see figure 1.2).

After the early recover from the 2009 world economic crisis, Africa’s economy was challenged in the year 2011 by the Arab revolutions. The continent’s growth cut down from 5% in 2010 to 3.4% in 2011. With the regaining of North African economies and continued enhancement in other regions, growth through the region countries has enhanced to 4.5% in 2012 and 4.8% in 2013. Importantly, as Europe faces its debt crisis, the short-run problems of the world economy remains. Therefore, the exported goods by African countries are now facing a fallback in their prices in global markets due to the weak international demand. This will challenges most African economies; however, commodities prices are expected to remain at levels that promising for most of African exporter.

In the past ten years, Africa has experienced high economic growth; in fact, in 2013 Africa was the world’s fastest-growing continent with a growth rate of 5.6% a year. According to the World Bank (2014), Africa’s Gross Domestic Product (GDP) is expected to continue rising by an average of over 6% each year. The African economy consists of trade, agriculture, manufacturing, and human resources of the continent. According to the World Bank (2015), recent growth in Africa’s GDP was because of the growth in the sale of commodities, services, and manufacturing.
Figure 1.2 shows the high growth in Africa’s GDP in the last ten years. In fact, in 2004, 2005, 2006, 2007, 2008, 2009 and 2013, Africa was the world’s fastest-growing region compared to East Asia & Pacific, Latin America. According to the World Bank 2015, Africa will have a key role in the world economic growth since Sub-Saharan Africa is the home of some fastest-growing countries across the world.

![Economic Growth Chart](image)

**Figure 1.2 : Economic Growth** (Source: World Bank, 2016)

In the past years, the fast economic growth of Africa was the result of increased domestic demand and better investment in the region. In fact, foreign direct investment inflows, in Africa, rose by 16% to $43 billion. In spite of this strong performance, economic growth between African countries is uneven. However, most African countries remain embarrassed by the nonexistence of improved infrastructure, weak business environment, absence of enough finance that provided by local institutions, effects of climate change and remaining internal conflicts. As solutions for these problems, the International Finance Corporation make known to a new set of consultative and investment solutions for African countries. Also, the World Bank has bring together to the African clients new sources of finance and better ways of doing business proficiently and sustainably.

---

Figure 1.3 shows trade in Africa is the highest compared with many regions, in fact, trade as a percentage of GDP in Africa reached the highest level on 2010 that was about 75% of African GDP. The figure also shows that trade in Africa one of the most important contributors to the growth of African economy, in fact, recent economic growth in Africa was due to growth in sales of goods and services besides manufacturing. Despite the huge reserves of natural resources in Africa such as minerals, timber, and oil, trade between Africa and other regions is difficult.

![Figure 1.3 : Trade as a Percentage of GDP](source: World Bank, 2016)

African countries have decided to work together in developing their natural and human resources for the good of all their people. However, the focus of African countries is to form a large number of economic and trading units while at the same time they aim to remove and overcome some of the barriers facing the individual states (African Union, 2013). This not only reveals that trade is an important factor contribute to the growth of African economy, but it also suggests that improving business environment in Africa strengthens the economy. There are many barriers facing intra-trade in the continent, thus, African Union suggests removing these barriers to enable intra-trade growth among the nations that leading to sustainable economic growth in Africa.
One has to think about how African countries would benefit more from trade as most of African economies depend on trade of goods and services. Trade have important role to play in African economies besides growing the GDP of African countries since it's proven that it reduce poverty rate among the poorer African people (Béné et al., 2010; Le Goff and Singh, 2014). However, many problems are currently facing trade in Africa, for instance, the poor and weak infrastructure such as -but not limited to- few poor ports, unimproved railways, old transportation system, and weak financial system. In this regards, African policy-makers have to develop infrastructure and financial services to facilitate trade, also, they have to improve business environment and attract more FDI to come into the region.

African economy is consists of many important sectors that generates and enhances the economic growth of the continent. The major economic sectors in Africa countries are: Agriculture, Energy, Infrastructure, Mining and Drilling, Manufacturing, and Investment. However, most of these sectors are need more improvement and require high advance technology that can only be gained through positive spillover effects from FDI.

Agricultural sectors in African countries need hard work to improve the, besides; more investment is needed to increase the total productivity of agriculture in Africa. It's worth to notice that facilitate doing business and trade will lead to enhance the export of agricultural goods from Africa to other countries. Also, this will reduce cost associated with agricultural goods’ exports that increases the competitiveness of such exports in the global market-place. Furthermore, attracting more FDIs develops the sector by transferring advance technology to the local farmers that reduces the production cost and increases the productivity. Agriculture is very important for all African since it reduce poverty rate among the poorer farmers (Sowman et al., 2014).

It's worth to mention that, for a community to have good economic opportunities, it should has sustainable access to electricity. This will lead to more new established businesses, growing the existing companies, and creates more jobs. It's also increases the opening and operating hours of the existing Businesses such as restaurants and shops. However, energy sectors in African countries are facing critical challenges such as high capital cost that required in this sectors, mainly, renewable resources remains one of the most serious barriers that faces the improvement of African energy sectors. Other barriers include the limited resources of water and the insufficient food security that critical for the life of people who work in this sector. Thus, African policy-makers have to attract more foreign direct investment in this
sector that returns more growth and development into the African economies.

The enhancement of the energy sectors in African countries will return more profits to the continent as the setup of new solar water heaters and such projects in energy sector tend to reduce poverty rate among the people who lives in those areas. Also, the setup of clean energy organizations has led to improvement in well-being, and general health of the individuals. Further, the operation of these projects also creates jobs, and improves authorization of the people because a localized level of energy operation. Also, energy projects can simplify the improvement of schools, and help teachers gain access to a wide variability of teaching instruments, such as potentially computers.

The relationship between infrastructure and economic growth is clearly critical in promoting sustainable economic growth and continues development\(^2\). In fact, limited access to energy, Internet and high cost of transport are the major deflators that harm economic growth and are relatively associated with the continued downgrading of African economies (Fedderke and Bogetic, 2009; Pradhan et al., 2014; Hochman et al., 2013). However, this has encouraged African governments to develop and improve infrastructure stock in African countries to become more cost-effective in the world marketplace.

Generally, strong investment in important infrastructure's facilities projects such as, but not limited to, roads, ports, airports tend to reduce the transportation cost which lead to reduce the costs related to trade. These investments will enhance the competitiveness of African firms in the world markets, also, will heighten the development in the continent. In fact, infrastructure development backings most of the economic activities as it’s very important as an inputs into the production procedures, also, it increases the productivity of other inputs that used in the production of goods and services (Rousseau and D’Onofrio, 2013; van et al., 2004; World Bank, 2015; Beladi et al., 2016).

The relationship between the economy and the infrastructure is very important since economic growth needs more infrastructure development. However, economic growth provides the resources to fund the infrastructure development projects. Infrastructure projects are important in reducing the production cost as it simplify the

\(^2\) Many researchers contend that infrastructure positively contributes to economic growth.
production process, those project enhance the economic growth. Otherwise, the failure to develop the proper infrastructure stock and services will harm economic growth by creating limited and poor infrastructure services that harm economic development and growth (Fedderke et al., 2006; Ianchovichina et al., 2013; Hochman et al., 2013; Moyo, 2013).

While Africa is a resource-rich continent in term of mineral reserves the old poor mining and drilling' methods reduce the benefits that can be gained from this sector on the economic growth of the region. In fact, advance technology is required to develop this sector that can only be occurred through more FDIs into the continent. This important sector can help in generating more economic growth and reduce poverty rate among the poorer areas in African countries (Pegg, 2006). However, in order to attract those FDIs, the poor business environment in African countries should be improved and enhanced so that FDIs spillover' effects take-place in African countries.

1.3 Foreign Direct Investment (FDI) in Africa

Foreign Direct Investment take place when a residents of a country obtain the ownership of assets in another country to produce, distribute, sell, and any other related activities (Moosa, 2002). Also, the United Nation’ World Investment Report defines FDI as (an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor. Importantly, the long-term used in the definition is to distinguish FDI from portfolio investment that characterized by being short-run in nature (Moosa, 2002).

FDI can be classified according to two points of views: the investor point of view (the source of FDI) and the host country' point of view (the recipient country). From the perspective of the investor, the types of FDI are horizontal, vertical, and conglomerate foreign direct investment (Caves, 1971). The horizontal foreign direct investment means that producing the same goods or/and services –as in the source country- in other country which is the host country which reflects a horizontal expansion for the firm. The vertical FDI, on the other hand, is undertaken for exploiting raw materials (backward vertical FDI) or to nearer to the consumers by expanding the distribution outlets (forward vertical FDI). Conglomerate FDI involves both horizontal and vertical FDIs, however.
From point-of-view of host country, the types of FDI are import-substituting, export-increasing, and government-initiated foreign direct investment. The import-substituting FDI means that producing goods and services that formerly imported by the host country in order to reduce the import of the country. The export-increasing FDI, on the other hand, is motivated to increase the export of the host country of raw materials and intermediate goods to the investing country or to other countries. Government-initiated FDI took place when government offers incentives to foreign investors in an attempt to eliminate the deficit of the balance of payment of the host country. It's worth to mention that Africa is a good place for all kinds of foreign direct investments.

FDI contributes to the economy of the host countries through many channels. First, it affects the total output and the economic growth by increasing the production of goods and services in the host economy. This will grow the total output and increases the economic growth of the host economy. In fact, FDI is an important mechanism to transfer advance technology to domestic firms, besides, it contribute to the growth more positively than the domestic investment does. Second, FDI reduces the unemployment rate through the job creation, for instance, FDI is capable in increasing employment directly by setting-up new facilities or indirectly by stimulating employment in distribution.

Third, FDI affect the balance-of-payment of receiving countries and tends to reduce the deficit of those countries. In this regard, the host country will gain more profits in foreign currencies which fills the gap in the balance-of-payment sheet, and thus, reduces the deficit of this country. Fourth, FDI play an important significant role in transferring the advance technology to the local firms, in this regard, the host countries will therefore speedup the availabilities to catch-up with the investing countries in term of technology. Fifth, FDI generates positive spillover effect onto the domestic firms and economic sectors such as, but not limited to, increasing the productivity, providing more training to the local labor-force, and increasing the trade flows of the country (Moosa, 2002).

The impact of FDIs on economic growth is a debatable issue; some studies found positive significant impact on growth while some others found negative impact (Herzer et al., 2008; Bengoa and Sanchez-Robles, 2003; Pegkas, 2015; Gohou and Soumaré, 2012). Also, some studies argue that the impact of FDI on growth is subject to a particular conditions such as developed financial markets, improved business environment, high level of human capital, and developed infrastructure stock (Azman-Saini et al., 2010; Azman-Saini et al.,
In addition, there is no agreement amongst all researchers regarding the impact of FDI on economic growth neither in the long-run nor in the short-run.

However, one has to consider the importance of FDIs in enhancing the performance of the economy in general and also its positive spillover impacts on other sectors in the host country’s economy. For instance, FDI by itself may generate economic growth by increasing the total output of the host country and/or by the job creation as well as technology transfer to the local firms (L. Zhang, 2017; Eddie and Yang, 2016). In fact, foreign companies tend to provide more training to their local workers in which they transfer their skills to other local workers. This could take place through labor mobility which more likely to happen as labors who have earlier worked with foreign companies are more capable to transfer their knowledge of new technologies to local labors and firms (Crespo and Fontoura, 2007). Moreover, domestic firms will get more benefits from the FDI spillover effects that might take place, so in such cases this will lead to more economic growth and economic development in the host countries (Moosa, 2002).

Also, productivity spillover effects from foreign direct investment (FDI) constitute one of the most debated issues in the literature on potential impacts of FDI. The topic is relevant in several aspects. One main – if not the most important – aspect is that FDI is not only seen as a source of capital but is also believed to foster economic growth and to contribute to the development process by bringing new technologies and knowledge to FDI host countries. In this regard, it is assumed that some of the technologies and the know-how located in the affiliates of multinational enterprises (MNEs) diffuse or – as in common parlance of the literature (for instance, Greenaway, 2007; Smeets, 2008) – “spill over” to other host country firms and affect their productivity levels positively.

This is why the governments of many developed and developing countries make considerable efforts to attract FDI inflows. However, theoretical considerations also conceive negative spillovers. The question arises as to which effect is predominant and whether an economy ultimately benefits from externalities in form of spillover effects, is affected adversely or remains unaffected. Therefore, the topic at hand is also highly relevant from the development policy angle.

This raises the need to examine the impact of FDI on economic growth in Africa, so that policy-makers get enough information that would help them in introducing the suitable policies. It is also valuable to
investigate the impact of FDI on African economic growth to fill the gap in addressing this issue in the literature that studied the impact of FDI on growth with the less-focus on African countries. Furthermore, FDI inflows in Africa are too low compared to other regions which highlights the need of conducting this study trying to improve and solve the problems that limit FDIs inflows in the continent.

Figure (1.4) shows FDI flows in Africa, East Asia & Pacific, and Latin America, it is widely clear that Africa have received the lowest FDI flows compared to other regions. This reflects the weak poor environment of Africa that failed in attracting the flows of foreign direct investment into the continent. Besides, political instability among African countries may reduce the flows of FDI in the region (Deseatnicov and Akiba, 2016).

The figure shows that FDI inflows in Africa are too low compared to other regions, it also shows that the inflows have increased slightly over the past years but still the lowest among the World. As a result, African Union encouraged governments to facilitate their regulations regarding investment and suggests that governments remove the barriers facing foreign investors to establish stable business environment. However, many facilities in Africa need more improvement to start attracting more FDI flows into the continent.
The foreign direct investment inflows in Africa are the lowest compared to other regions, even if it is slightly increased over the past years but still the lowest in the world (see Figure 1.4). The small increase in foreign direct investment inflows in Africa was due to increases in the discoveries of new natural resources. FDI in Africa have increased from US$ 19.1 billion in 2005 to US$ 40.6 billion in 2013. The slight increase of foreign direct investment in Sub-Saharan Africa was by 4.7% in 2013 but declined in North Africa while intra-African investment increased.

There is a noticeable divide between FDI trends in North Africa versus Sub Saharan Africa (SSA). FDI projects in North Africa declined by nearly 30% but in SSA the projects increased by 4.7%, reversing the decline of 2012. This further widened the gap between the two sub regions, with SSA’s share of FDI projects exceeding 80% for the first time. While the UK remains the lead investor into the continent, intra-African investment continues to rise steadily.

Investors are also looking beyond the more established markets of South Africa, Nigeria and Kenya to expand their investment, as well as...
moving into more consumer-related sectors as Africa’s middle class expands. Figure (1.5) shows that the inflows of the foreign direct investment in Africa have slowly increased over the past years. For instance, in 2015, the inflows of the FDI were $19.5 billion and increased to $16.3 billion in 2006. The inflows of FDI increased in 2007 to $29.9 billion and then increased to $40.6 billion in 2013. The inflows of foreign direct investment in Africa have increased slightly over the past 7 years.

However, FDI flows into the continent still the lowest among all regions in the world, this arises the need to examine the impact of business environment and other variables on FDI flows. It is also important to investigate how FDI affects African economic growth since FDI by itself doesn’t generate growth (Azman-Saini et al., 2010), this will help policy-makers to introduce effective policies in this regard.

Figure (1.5) shows the relationship between FDI and economic growth in Africa. According to (Sadik and Bolbol, 2001), FDI not only have positive significant impact on economic growth but also generate positive spillover effects on other sectors. Alfaro et al. (2004) argue that countries with higher level of financial development gain more benefits from FDI on their economic growth. In this regard, the higher financial development the higher FDI flows to the countries, also, high
institutions quality attracts FDI flows to the economy (Tolentino, 2010). Figure (1.7) show the relationship between financial development and FDI flows in Africa.
1.4 Business Environment in Africa

In the past years, the World Bank has started publishing the annual Doing Business reports since 2004 to examine the scope and manner of regulations that strengthen business activities and those that constrain them. These reports compare countries based on many indicators of business environment. Doing Business reports ranking countries according to the regulations affect 11 areas such as starting a business, getting electricity, getting credits, registering a property and trading across borders. It also covers the issue of how financial development affect doing business in a country, not only this but also it include the institutions quality and how it may affect doing business and economic growth.

Doing Business report highlight issues regarding how it is easy or difficult for the local investors to start and run a small or medium-size business when act in accordance with relevant existing regulations. It measures and tracks changes in regulations that may affect 11 areas that related to doing business: starting a new business, dealing with construction licenses. It is also concerns about how easy to get the electricity, to register a property, and to get a credit. Besides, it also highlights how protected the minority investors, how easy to pay taxes, easy of cross-borders trading, enforcing contracts, resolving insolvency and labor market regulation.

Doing Business 2017 offerings data for the labor-market rule indicators in a form of an annex. Importantly, there is a more information available in the full report (see Doing Business Reports). Doing Business 2017 offerings the indicators, evaluates their relationship with economic outcomes and provides business regulatory reforms3. It is worth to mention that policy-makers should have compared business regulatory in their domestic economy in regard to other economies.

Then, policy-makers may improve their economy’s regulatory environment for foreign and local investors. Doing Business Reports provides ranking of countries in term of the ease of doing business built on certain indicators that affect doing business of small and medium-size of firms and companies. In these reports, countries are ranked from 1 to 190 based on how easy or difficult to do business. Doing Business presents results for 2 aggregate measures: the distance to frontier score and the ease of doing business ranking.

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3 The data, along with information on ordering Doing Business 2017, are available on the Doing Business website at (www.doingbusiness.org).
ranking of economies is determined by sorting the aggregate distance to frontier scores, rounded to two decimals. An economy’s distance to frontier score is indicated on a scale from 0 to 100, where 0 represents the worst performance and 100 the frontier. (See Doing Business Report (2017)).

Figure (1.8) shows the ranking of global countries in term of ease of doing business and business environment. The figure clearly shows that Africa have the poorest business environment compared to other regions, also it shows that in term of ease of doing business most of African countries ranked at the end of the countries ranking' list (See Figure (1.9)).
Figure 1.8: Ease of Doing Business
(Source: Doing Business report, 2017)
Figure 1.9: Countries Ranking, Ease of Doing Business
(Source: Doing Business Report, 2017)
In general, African countries have a poor business environment that limits the economic growth by reducing the output of the manufacturing sector. For example, Africa has the highest transportation cost in the world while only 30% of African population have access to electricity. Also, only 27% of Africa population are Internet users and tax is too high in Africa (African Union, 2013). However, in the past years, African countries started improving their business environment.

It’s now widely accepted that business environment plays an important role in the decision made by foreign investors regarding the final destination of their investment. For instance, health of domestic labor force as well as education quality attract foreign direct investment (FDI) flows to come in the region (Salike, 2016). However, FDI flows in Africa are very low compared to other regions, this is not only due to poor business environment but also because of poor institutions quality in Africa (A Decade of African Governance, 2016).

In Africa, business environment is very poor compared to other region. However, in the past years African Union start encouraging all states members to improve business environment and facilitate doing business as well as removing barriers that facing traders and investors. This will not only grow the economy of Africa as it depends mostly on trade, but also will attract foreign direct investment into the continent. Figure (1.10) shows the relationship between business environment and economic growth in Africa, it shows that business environment and economic growth have a long-run relationship. This confirms the need of conducting this study and therefore the impact of business environment on economic growth should be estimated.

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Figure (1.11) shows how business environment is important in attracting FDI flows; this reflects why FDI flows in Africa are too low compared to other regions due to the poor environment in Africa. The World Bank stated clearly that ease of doing business in a country generates benefits in both micro-and-macro levels in the economy. Doing business reports show that how easy or difficult to start a new business is highly related to investment level in the economy. Figure (1.11) presents the direction of the relationship between business environment and FDI in Africa. It shows that the relationship is positive which confirm that business environment is very important for FDI and economic growth in the continent.
However, the factors that affect business environment are too many to examine them all in one study. Therefore, Mo Ibrahim Foundation has generated an index to cover all areas that affect business environment in Africa\textsuperscript{5}.

The current opinion focuses on the potential aftershock of deflating commodities prices and third term challengers to democracy. The Ibrahim' Index results lead us to qualify this analysis. What is striking is that these are not the areas which demand most attention. The Index clearly reveals that deteriorating trends in Safety and Rule of Law have held back the continent’s progress in Overall Governance over the last decade. Whilst a majority of Africa’s citizens live in countries that have seen improvements in Participation and Human Rights, Sustainable Economic Opportunity or Human Development, all four components that make up Safety and Rule of Law have deteriorated.

\textsuperscript{5} The Mo Ibrahim Foundation is an African foundation, established in 2006 with one focus: the critical importance of governance and leadership in Africa. It is their belief that governance and leadership lie at the heart of any tangible and shared improvement in the quality of life of African citizens.
Almost half of Africa’s 54 countries have recorded their worst score in this category in the last three years. This is holding back the continent's progress and remains the biggest challenge to its future. Figure (1.12) shows the components of African governance index that published by Mo Ibrahim Foundation since 2006, it also shows that business environment is one of those components.

Figure 1.12: Ibrahim Index Components.
(Source: Mo Ibrahim Foundation, 2016)

According to Mo Ibrahim Foundation, business environment index calculated from 6 sub-indicators which are: investment climate, competition and competitive environment, bureaucracy and red tape, customs procedures, soundness of banks and employment creation. To construct the index, the foundation’s research team has collected data from 34 sources contains 166 variables that measures governance concepts. It also covers all 54 African countries for 15 years of data length from 2000 to 2015.

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6 For more information, please refer to Mo Ibrahim Foundation at [mo.ibrahim.foundation](mo.ibrahim.foundation), and see the reports published there.
1.5 Poverty in Africa

Africa is a resource-rich continent but most African people are poor, in fact, poverty in Africa is a serious problem facing the region. Poverty in Africa means the lack of basic human needs that are currently facing many people in African countries. For instance, 57% of the poorest countries in the world are located in the African region, including Liberia, Ethiopia, and Zimbabwe. In fact, in the past two years, Africa’s second largest country\(^7\), has also been ranked the poorest in the world with a total GDP of $394.25 in 2013.

According to World Bank, in 2013, the top ten countries with the highest number of people that are extremely poor were all in the African continent. The definition of extreme poverty is living on $1.25 or less per day (World Bank, 2013). In 2010, more than 400 million people, in Africa, were living in extreme poverty. According to the World Bank, these people who are living on $1.25 per day equals to around 48% of the population in the continent in 2010.

In 2010, the Food and Agriculture Organization (FAO), United Nations, estimated that more than 230 million people (around 31% of the African population) in Africa were hungry. This is the highest percentage of any region across the world. In addition, the U.N. Millennium Project reported that more than 40% of all Africans might not regularly get enough food.

In Africa, around 580 million people have no access to electricity. As a result, around 80% of the population depends on biomass products such as charcoal, dung and wood in order to cook. Extending this further, around 37% of the 735 million people globally who lack access to safe water, are living in the African continent. In fact, poverty in Africa results in over 500 million people suffering from water-related diseases. According to the United Nation' Millennium Project, around 50% of Africans have a water-related illness like cholera\(^8\).

Moreover, around one million people, mostly children under five, die from malaria every year. In fact, about 90% of worldwide' malarial deaths occurred in Africa and around 80% of these malarial deaths are children in Africa. The United Nation’ Millennium Project calculated that, every 30 seconds, a child dies from malaria in Africa or about 3,000 every day (World Bank, 2017).

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\(^7\) The Democratic Republic of the Congo.
\(^8\) Refer to the World Bank: Africa’s poverty facts.
Less than 20% of the women in Africa have access to education. Most importantly, uneducated women in Africa are twice as likely to contract AIDS, and 50% less likely to immunize the children they have. Meanwhile, the children in Africa mostly have five years of schooling, and as a result, they only have a 40% higher chance of survival in. African women are about 230 times more likely to die during pregnancy or childbirth than women in other regions are. In other words, approximately one in each 16 women in African countries dies during pregnancy or childbirth compared to only one in 4,000 women in North America (World Bank, 2015).

Poverty in Africa is one of the serious problems that facing mostly all African, in fact, more than 40% of African might not regularly get enough food. Moreover, about 31% of African population are extremely poor, and thus, they are hungry. In this regard, African Union started brings more attention to this important issue. However, the continued high economic growth in the past years will reduce poverty rate in Africa as it have positive significant impact on poverty reduction (Diao and Pratt, 2007). Figure (1.13) shows the direction of the relationship between economic growth and poverty in Africa, it shows that high growth will lead to further poverty decrease in the continent.

![Figure 1.13 : Growth and Poverty in Africa](image-url)
To reduce poverty in African policy-makers should have improved business environment in the region to attract FDI flows into Africa since FDI significantly reduce poverty (Gohou and Soumare, 2012). Figure (1.14) shows the direction of the relationship between foreign direct investment (FDI) and poverty in Africa, it shows the how strong the relationship between the two variables. This raises the need to examine the impact of FDI on poverty rate in Africa besides other determinants of poverty.

![Figure 1.14: FDI and Poverty in Africa](image)

### 1.6 Problem Statement

The impact of FDIs on economic growth is a debatable issue; some studies found positive significant impact on growth while some others found negative impact (Herzer et al., 2008; Bengoa and Sanchez-Robles, 2003; Pegkas, 2015; Gohou and Soumaré, 2012). Also, some studies argue that the impact of FDI on growth is subject to a particular conditions such as developed financial markets, improved business environment, high level of human capital, and developed infrastructure stock (Azman-Saini et al., 2010; Azman-Saini et al., 2010). Generally, there is no agreement amongst all researchers regarding the impact of FDI on economic growth neither in the long-run nor in the short-run.
However, foreign direct investment plays an important role in growing the economies; in fact, FDI contributes positively on-to the economic growth either in a direct manner or in indirectly through other channels (Herzer et al., 2008). Besides, FDI have positive spillover effects on other sectors or firms, and helps in the issue of advance-technology transfer (Gui-Diby, 2014). Furthermore, FDI develops the financial system of the host countries as well as reduces the unemployment rate in the receiving countries by the job creation (Sbia et al., 2014).

Foreign direct investment flows in Africa are too low compared to other regions; in fact, FDI in Africa is the lowest among the world's regions (See Figure (1.4)). Importantly, since African economic growth continued rising in the past years so it is very important to investigate the empirical impact of FDI on growth in Africa. This will not only help policy-makers to introduce polices to attract FDI, but also to develop business environment in African countries owing its important role in attracting FDI.

In the past years, the World Bank started publishing the doing business reports to compare countries according to how easy or difficult to do business. In this regards, business environment is critical in enhancing the economic growth especially in developed countries. Meanwhile, improved business environment attract local investor as well as foreign investor since doing business becomes much easier. Furthermore, developing business environment is very important for countries that depend on trade of goods and services as major contributor to economic growth.

However, Africa has the poorest business environment compared to other region of the World. In this regard, Africa has the higher transportation cost in the world, the lowest infrastructure stock compared to others. Not only this but also Africa has the lowest human development in term of education, health and income. In the same line, African countries are ranked at the bottom of the list of business environment ranking that published by the World Bank (Doing Business, 2017). This rises the need to empirically examine the impact of business environment on FDI flows to Africa as African economy depend mostly on trade of good and services (See Figure (1.3)).

It's now widely accepted that high human development contributes positively to economic growth, for instance, educated and healthier labors are more likely to enjoy the production process and produce more. Also, they are more likely to create innovative and new production techniques, besides, they are more likely to have high
income. Further, since the high income of those labors then they will spend more which increase the final consumption of households and generate more economic growth.

However, Africa is a resource-rich continent but most African are poor, in fact, poverty in Africa is a serious problem that facing the region. Furthermore, the top ten poorest countries in the world are all located in Africa, besides; more than 73% of the poorest countries in the planet are also located in the region (World Bank, 2015). Decade after decade, international organizations and African politicians have failed in promoting a noticeable poverty reduction in the continent. Neither they generate more economic growth in Africa, nor did they help in improving the infrastructure in the region. In fact, Africa was the only place in the world where poverty is continuing rising, however, recently that human development in the continent has started to slowly improve.

This issue is very important in Africa and must be solved, therefore, this study aims to examine the impact of foreign aid and FDI and economic growth on poverty reduction in Africa. This will not only help in identifying the empirical impact of those variables on poverty, but also will give some policy implications that help policy-makers.

1.7 Objectives

The main objective of this study is to investigate the economic relationship between economic growth, foreign direct investment, and poverty in Africa. The sub-objectives of the study are:

1. to estimate the impact of foreign direct investment on economic growth in Africa.
2. to investigate the impact of business environment on foreign direct investment in Africa.
3. to examine the determinants of poverty in Africa.

1.8 Significance of the Study

First, foreign direct investment flows in Africa are the lowest compared to other regions. Thus, this study established a new point of view that examined how business environment affects investors' decisions regarding allocating their investments. The significant contribution of this study is that it provides strong evidence for the importance of business environment on attracting more FDI flows in Africa. Since none of the previous literature has highlighted this issue by using an index covers most of the areas that affect business environment, this
study comprised all these areas in one index. This study also contributes to the existing literature in the determinants of FDI in Africa by examining the impact of financial development and institution's quality.

Second, the determinants of economic growth is a well-investigated issue in both theoretical and empirical points of view. However, this study examined the impact of business environment on economic growth in Africa for the first time by using an index covers all areas of regulations and how easy to do business. It contributes to the existence idea of FDI-led-growth with more focus on African countries to fill the gap in the literature. The study also significantly contributes to existence knowledge in the areas of how financial development and institution's quality may affect economic growth given the less focus on African countries.

Third, poverty remains a serious problem facing African countries, a few studies have focused on this issue in Africa, however. The contribution of this study is that it provides empirical evidence about the impact of foreign direct investment on poverty in Africa since a few studies have examined the relationship in Africa. It also contribute to the existence studies that investigated the impact of economic growth on poverty reduction given the less-focus on African countries by the previous literature. Importantly, the significant contribution of this study is that it provided empirical justification about how business environment attracts FDI and enhances economic growth owing their importance in reducing poverty in Africa.

The study will fill the gap in addressing the importance of business environment for the African economy and the gap in addressing the solutions of poverty in the region. This study will provide a better foundation for African policy-makers to introduce and develop policies to manage and improve the business environment for the good of the region and to introduce effective policies to reduce poverty in the region.

The few studies have examined the effect of business environment and FDI on growth and/or the effect of growth on improving the existing business environment and attracting FDI flows. More studies need to be carried out to fill the gap in addressing these issues in Africa. Thus, this study is quite important for all African policy-makers.
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