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FOREIGN DIRECT INVESTMENT IN KENYA

By

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A case study of Kenya's FDI between 1980 and 2006, in partial fulfillment for my Masters in economics, course XET502: ADVANCED MICROECONOMIC THEORY II, School of economics, University of Nairobi.

1. Introduction

An agreed framework definition of foreign direct investment (FDI) exists in the literature. That is, FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency (World Bank, 1996). Such investments may take the form of either "greenfield" investment (also called "mortar and brick" investment) or merger and acquisition (M&A), which entails the acquisition of existing interest rather than new investment.

In corporate governance, ownership of at least 10% of the ordinary shares or voting stock is the criterion for the existence of a direct investment relationship. Ownership of less than 10% is recorded as portfolio investment. FDI comprises not only merger and acquisition and new investment, but also reinvested earnings and loans and similar capital transfer between parent companies and their affiliates. Countries could be both host to FDI projects in their own country and a participant in investment projects in other countries. A country's inward FDI position is made up of the hosted FDI projects, while outward FDI comprises those investment projects owned abroad.

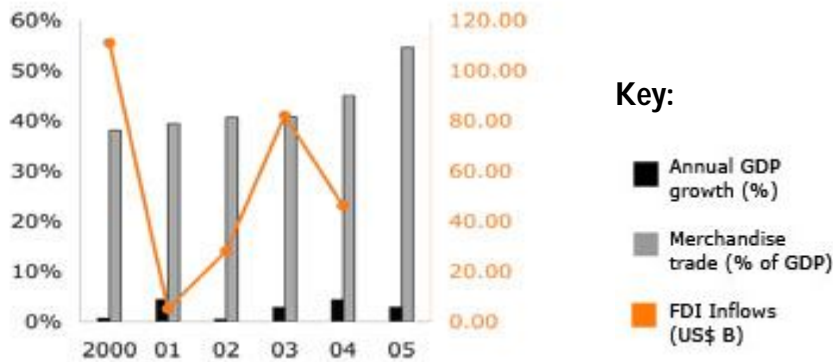
Sub-Saharan Africa as a region now has to depend very much on FDI for so many reasons. The preference for FDI stems from its acknowledged many advantages. Therefore African countries have struggled to implement FDI, and these efforts by several African countries to improve their business climate stems from the desire to attract FDI. In fact, one of the pillars on which the New Partnership for Africa's Development (NEPAD) was launched was to increase available capital to US\$64 billion through a combination of reforms, resource mobilization and a conducive environment for FDI. Unfortunately, the efforts of most countries in Africa to attract FDI have been futile. This is in spite of the perceived and obvious need for FDI in the continent. The development is disturbing, sending very little hope of economic development and growth for these countries. Further, the pattern of the FDI that does exist is often skewed towards extractive industries, meaning that the differential rate of FDI inflow into sub-Saharan African countries has been adduced to be due to natural resources, although the size of the local market may also be a consideration

Foreign Direct Investment (FDI) not only provides the African countries with much needed capital for domestic investment, but also creates employment opportunities, helps transfer of managerial skills and technology, all of which contribute to economic development. Recognizing that FDI can contribute a lot to economic development, all governments of Africa including that of Kenya want to attract it. Indeed, the world market for such investment is highly competitive, and Kenya in particular, seeks such investment to accelerate her development efforts.

With liberal policy frameworks becoming common place and losing some of their traditional power to attract FDI, Kenya is paying more attention to the measures that actively facilitate it. Hence, the economic determinants remain very important. What is likely to be more critical in the future is the distinctive combination of location advantages, especially, created assets that Kenya can offer potential investors.

The level of FDI in Kenya has been low and stagnant over the past couple of years and well below Kenya's potential. There has also been a worrying trend of foreign investors moving out of Kenya and gravitating to other countries. This is evident by the below graph, which briefly describes the relationship between FDI and GDP in Kenya from 2000 to 2005.

FDI and GDP in Kenya, 2000-2005



Source: *World development Report 2005, The World Bank.*

This study will be significant in the sense that Kenya has experienced a decreasing trend of FDI inflows over the years. It should be noted that FDI inflows to Kenya is very crucial because it serves as a source of capital and given that foreign aid has been dwindling over the years. This study is important in the sense that FDI stimulates domestic investment, promotes economic growth and creates employment opportunities. Some studies have been carried out to examine the determinants of FDI in African countries, but unfortunately, no studies have been carried out specifically on the linkage between FDI and economic growth in Kenya.

The studies that have been so far conducted were cross-country studies, usually employing comparative analysis using some of the African /or developing countries including Kenya. Hence, it is necessary to carry out an empirical investigation to find out the factors that influence FDI decisions in Kenya and explore the empirical relationship between FDI and economic growth in Kenya.

The findings of this study will be significant to both academicians and policymakers in the following way; first, it will add to the knowledge of the researchers in this field of study and secondly, it will serve as a guide to both policy makers and academicians.

The main objective of the study therefore is to examine the relationship between FDI inflows and economic growth in Kenya and the policy concerns it engenders. The specific objectives are to:

- Identify the key factors that influence FDI decisions in Kenya.
- Explore the empirical relationship between FDI and economic growth in Kenya.

2. Literature review

Renewed research interest in FDI stems from the change of perspectives among policy makers from “hostility” to “conscious encouragement”, especially among developing countries. FDI had been seen as “parasitic” and retarding the development of domestic industries for export promotion until recently. However, Bende-Nabende and Ford (1998) submit that the wide externalities in respect of technology transfer, the development of human capital and the opening up of the economy to international forces, among other factors, have served to change the former image.

Caves (1996) observes that the rationale for increased efforts to attract more FDI stems from the belief that FDI has several positive effects. Among these are productivity gains, technology transfers, introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to markets.

Borensztein et al. (1998) see FDI as an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment.

On the basis of these assertions governments have often provided special incentives to foreign firms to set up companies in their countries. Carkovic and Levine (2002) note that the economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spillovers.

Curiously, the empirical evidence of these benefits both at the firm level and at the national level remains ambiguous. De Gregorio (2003), while contributing to the debate on the importance of FDI, notes that FDI may allow a country to bring in technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy. FDI may also bring in expertise that the country does not possess, and foreign investors may have access to global markets. In fact, he found that increasing aggregate investment by 1 percentage point of GDP increased economic growth of Latin American countries by 0.1% to 0.2% a year, but increasing FDI by the same amount increased growth by approximately 0.6% a year during the period 1950–1985, thus indicating that FDI is three times more efficient than domestic investment.

A lot of research interest has been shown on the relationship between FDI and economic growth, although most of such work is not situated in Africa especially Kenya. The focus of the research work on FDI and economic growth can be broadly classified into two. First, FDI is considered to have direct impact on trade through which the growth process is assured (Markussen and Vernables, 1998). Second, FDI is assumed to augment domestic capital thereby stimulating the productivity of domestic investments (Borensztein et al., 1998; Driffield, 2001). These two arguments are in conformity with endogenous growth theories (Romer, 1990) and cross country models on industrialization (Chenery et al., 1986) in which both the quantity and quality of factors of production as well as the transformation of the production processes are ingredients in developing a competitive advantage. FDI has empirically been found to stimulate economic growth by a number of researchers (Borensztein et al., 1998; Glass and Saggi, 1999). Dees (1998) submits that FDI has been important in explaining China's economic growth, while De Mello (1997) presents a positive correlation for selected Latin American countries. Inflows of foreign capital are assumed to boost investment levels.

Blomstrom et al. (1994) report that FDI exerts a positive effect on economic growth, but that there seems to be a threshold level of income above which FDI has positive effect on economic growth and below which it does not. The explanation was that only those countries that have reached a certain income level can absorb new technologies and benefit from technology diffusion, and thus reap the extra advantages that FDI can offer. Previous works suggest human capital as one of the reasons for the differential response to FDI at different levels of income. This is because it takes a well-educated population to understand and spread the benefits of new innovations to the whole economy. Borensztein et al. (1998) also found that the interaction of FDI and human capital had important effect on economic growth, and suggest that the differences in the technological absorptive ability may explain the variation in growth effects of FDI across countries. They suggest further that countries may need a minimum threshold stock of human capital in order to experience positive effects of FDI.

Balasubramanyan et al. (1996) report positive interaction between human capital and FDI. They had earlier found significant results supporting the assumption that FDI is more important for economic growth in export-promoting than import-substituting countries. This implies that the impact of FDI varies across countries and that trade policy can affect the role of FDI in economic growth.

The neoclassical economists argue that FDI influences economic growth by increasing the amount of capital per person. However, because of diminishing returns to capital, it does not influence long-run economic growth. Bengos and Sanchez-Robles (2003) assert that even though FDI is positively correlated with economic growth, host countries require minimum human capital, economic stability and liberalized markets in order to benefit from long-term FDI inflows. Interestingly, Bende-Nabende et al. (2002) found that direct long-term impact of FDI on output is significant and positive for comparatively economically less advanced Philippines and Thailand, but negative in the more economically advanced Japan and Taiwan. Hence, the level of economic development may not be the main enabling factor in FDI growth nexus. On the other hand, the endogenous school of thought opines that FDI also influences long-run variables such as research and development (R&D) and human capital (Romer, 1986; Lucas, 1988).

Impact of FDI on Economic Growth in Kenya

Kenya boasts to be the most industrialized country in East Africa, and one of the top performing countries in Sub-Saharan Africa. This is because Kenya provides an impressive array of reasons to invest in its industries. The country is reported by foreign investors to have a well developed port system. Kenya is also a member of as the East African Commission of 93 Million people, where trade is envisaged to flow freely across Uganda, Tanzania and Kenya by 2013. In addition to this, Kenya's membership in common Market for Eastern & Southern Africa, with nearly 385 Million people, thereby encouraging a number of international companies to increase substantially in the recent years. In 2003, top exports included horticulture (26.7%) and tea (24%), followed by apparel, coffee, iron and steel, soda ash, fish and plastic.

Despite having one of the most diversified economies in the region, Kenya's FDI flows have been consistently lower than those of its neighbours in recent years. 2003 did see a sharp rise in FDI inflows, totaling USD 82 Million, a considerable upturn from 2002, where FDI inflows totaled just USD 28 Million. Inflows settled at 46 Million in 2004. The main sources of FDI in Kenya are India, China, UK and Germany. The government implemented reforms in the legal framework for FDI in order to encourage investment. Some of these incentives include abolishing exports and import licensing; rationalizing and reducing import tariffs; revoking all export duties and current account restrictions, freeing Kenya shillings exchange with domestic banks; and removing restrictions on borrowing by foreign as well as domestic companies.

Restrictions on investment included changes stipulated in 2004, this was in the investment promotion Act requiring a minimum investment of USD 500,000. The act also introduced requirements that the investment must create employment for Kenyans, generate government revenues and bring new technology into the country. These are among various factors considered as key factors to growth measurement in a country.

Among the key factors to growth are, Human resources and international transportation infrastructure, of which are two key aspects of Kenya's attractive investment environment. Kenya boasts of the highest literacy rates resulting in a high level of qualified upper level staff and skilled labour. This large supply of labour also contributes to fairly low wage levels. Flexible employment regulations make workforce management comparatively easy for companies in Kenya. Kenyan firms also benefit from access to well developed sea shipping and air freight services. Investors reported some of low prices in official rentals, and utility costs are at a competitive level. In part, this is due to the relatively low cost of water at USD 0.42/ cubic meter. Kenya's EPZ's also strengthen the operating environment for zone based industries, as these areas have comparatively good electrical, water and telecommunications and connections; conducive environments for foreign direct investment.

Summary of the Literature Review

The consensus in the literature seems to be that FDI increases growth through productivity and efficiency gains by local firms. The empirical evidence is not unanimous; however, available evidence for developed countries seems to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms (Globeram, 1979). The results for developing countries are not so clear, with some finding positive spillovers (Blomstrom, 1986) reporting limited evidence. Still others find no evidence of positive short-run spillover from foreign firms. Some of the reasons adduced for these mixed results are that the envisaged forward and backward linkages may not necessarily be there (Aitken et.al. 1997). Further, the role of FDI in export promotion remains controversial and depends crucially on the motive for such investment (World Bank, 1998). The consensus in the literature appears to be that FDI spillovers depend on the host country's capacity to absorb the foreign technology and the type of investment climate (Obwona, 2004).

The review also shows that the debate on the impact of FDI on economic growth is far from being conclusive. The role of FDI seems to be country specific, and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the recipient countries. Most importantly the script mostly mentions Human capital as an important tool in measuring FDI effects to economic growth. (Romer, 1986; Lucas, 1988).

Most studies on FDI and growth are cross-country evidences, while the role of FDI in economic growth can be country specific. Further, only a few of the country specific studies actually took conscious note of the endogenous nature of the relationship between FDI and growth in their analyses, thereby raising some questions on the robustness of their findings. Finally, the relationship between FDI and growth is conditional on the macroeconomic dispensation the country in question is passing through. In fact, Zhang (2001) asserts that "the extent to which FDI contributes to growth depends on the economic and social condition or in short, the quality of the environment of the recipient country". In essence, the impact FDI has on the growth of any economy may be country and period specific, and as such there is the need for country specific studies.

3. Facts about FDI in Kenya

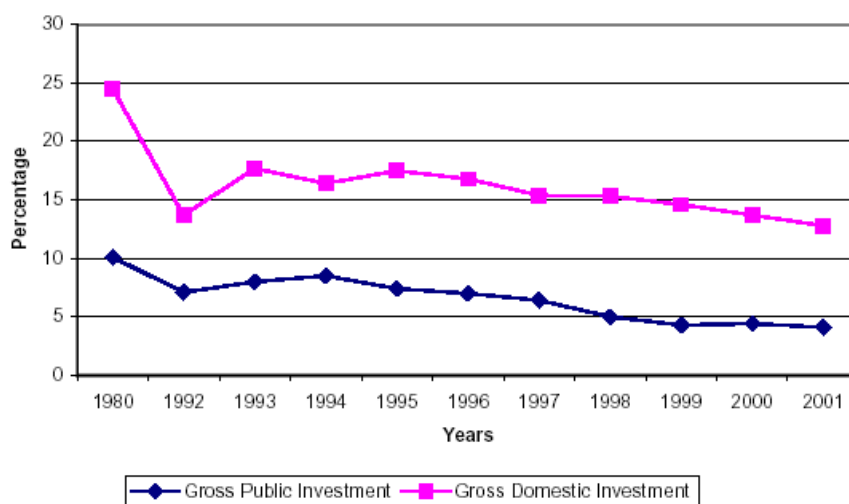
It is now widely acknowledged that foreign direct investment (FDI) is an important aspect of the recent wave of globalization. UNCTAD (2001) notes that FDI in the world rose from US\$57 billion in 1982 to US\$1,271 billion in 2000. Even so, only a few countries have been successful in attracting significant FDI flows. Indeed, Africa as a whole – sub-Saharan Africa (SSA) in particular – has not particularly benefited from the FDI boom. For most of the time since 1970, FDI inflows into Africa have increased only modestly, from an annual average of about US\$1.9 billion in 1983–87 to US\$3.1 billion in 1998–1992 and US\$4.6 billion in 1991–1997.

Although UNCTAD's *World Investment Report 2004*, reported that Africa's outlook for FDI is promising, the expected surge is yet to be manifest. FDI is still concentrated in only a few countries for many reasons, ranging from negative image of the region, to poor infrastructure, corruption and foreign exchange shortages, an unfriendly macroeconomic policy environment, among others.

Analysis over the last decade to 2001 shows that Kenya lost its competitiveness in attracting investment. Kenya also lost in terms of retaining the stock of investment. The loss in Kenya's investment competitiveness is the result of many inter-connected factors such as negative perception by investors about political instability, poor governance, corruption, inadequate infrastructure, insecurity, crime, theft, and policy instability.

Private investment which was growing at an average of 10% between 1985 and 1989, only grew by 0.4% between 1997 and 2001. Similarly, the level of gross domestic investment as a ratio of GDP declined steadily from 1994 to 2001 as shown in Chart 2. Gross public investment, which comprised roughly 10% of GDP in 1980, declined to merely 4.1% in 2001.

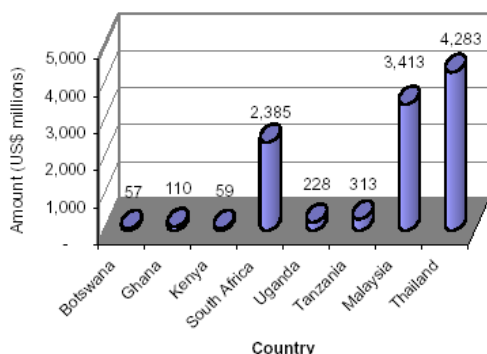
Chart 2: **GROWTH INVESTMENT AS A PROPORTION OF GDP, 1980-2001**



Source: *World Development Report 2001, The World Bank*

In terms of foreign direct investment, Kenya received between 1997 and 2002 an annual average of USD 59 million in FDI or 25.7% of what was received by Uganda or 18.7% of the FDI that went to Tanzania during that period. Chart 3 below gives a comparison between Kenya and other countries in terms of the average annual FDI received between 1997 and 2002. The figures indicate the wide divergence between the FDI received in Kenya compared to other parts of the world.

CHART 3: AVERAGE ANNUAL FDI INFLOWS, 1997-2002



Source: World Development Report 2002, The World Bank

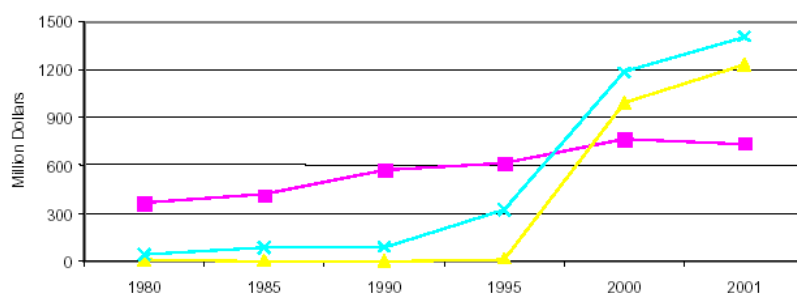
In terms of net stock of foreign direct investment, Kenya's share which was 15% among the East African countries during the first half of the 1990s decade plunged to less than 6% compared with Uganda's meteoric rise from 8% to 50% as shown in Table 1 and Chart 4.

Table 1: Net stock of Foreign Direct Investment (Millions of USD)

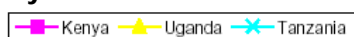
Country /Year	Kenya	Uganda	Tanzania	EAC	Other SSA countries	Sub-Saharan Africa
1980	368	9	47	424	21603	22027
1985	416	7	91	514	15599	16113
1990	569	4	93	666	12244	12910
1995	614	17	325	956	18123	19079
2000	764	990	1180	2934	57891	60825
2001	737	1226	1404	3366	71727	75093

Source: World Investment Report 2002, United Nations publications

CHART 4: NET STOCK OF FDI IN KENYA, UGANDA AND TANZANIA, 1980-2001



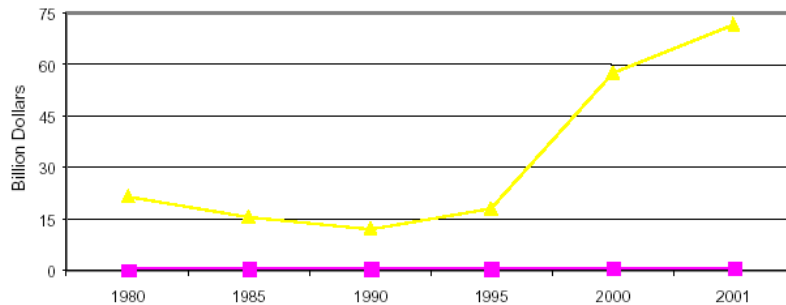
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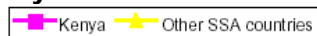
Source: World Investment Report 2002, United Nations publication

Kenya's loss of FDI was even more dramatic in the 1990s decade, with its share in the SSA region falling from 2% in the first half of the decade to less than 0.4% in the second half of the decade as shown in Table 1 and Chart 5.

CHART 5: NET STOCK OF FDI IN KENYA COMPARED TO SSA COUNTRIES



Key:



Source: *World Investment Report 2002, United Nations publication*

Due to the loss of competitiveness in attracting foreign direct investment, Kenya now ranks after Uganda and Tanzania in receipt of annual net inflows of foreign direct investment to the EAC countries.

Kenya is also now third after Tanzania and Uganda in hosting foreign direct investment capital stock in the region having lost her leading position over the two decades to 2001. While two decades ago Kenya held 87% foreign ownership of companies in the East Africa region, by 2001 only 22% of foreign ownership in the East Africa region was in Kenya compared to 36% and 42% in Uganda and Tanzania respectively.

Reasons for Kenya's Loss of FDI Competitiveness and Improvements made

Kenya's loss of FDI competitiveness relative to other countries in sub-Saharan Africa is explained by the hostile business environment that characterized the situation in Kenya during the last ten years or so. This hostile business environment, has however been drastically improved in the recent years as per analyzed by the World Bank report on "Doing Business, 2008 in Kenya.

While the numbers of business start up procedures are almost the same across countries, Kenya has drastically improved this condition by reducing the number from 68days in 2002 to 44 days in 2006. In addition currently it costs 4.7 percent of property value to register a business in Kenya, the same costs only 2.7 percent in Thailand and 3.8 percent in South Africa. The time to acquire credit has also improved much to an extent that earned Kenya Rank 13 in Getting Credit all over the world. These are some of the improvements so far made in the recent years.

This implies that Kenya is creating a friendlier business environment. This is because 110 business licenses have been eliminated, with plans underway to cut 314 and simplify more than 600 licenses; There is a more efficient company registry that has saved 14 days in registration of new companies; Boarder sources of Information for the private credit bureau has been achieved and will facilitate access to credit especially for women; and finally there is an allowance of private land valuation experts which has led to a faster turnaround of one week instead of one month for land valuation.

Although this is good, there are still some factors explaining Kenya's loss of competitiveness in attracting investment are listed in a survey carried out by World Economic Forum working with The International Finance Corporation on Doing Business, 2008 including Kenya. Ranking based on the survey show Kenya loosing out because of risks associated with:

- Corruption
- Employing workers
- Crime and theft
- Inadequate infrastructure
- Protecting Investors
- Trading across boarders
- Enforcing Contracts
- Closing a business

With respect to economic reforms, Kenya must aim at erasing the country's long track record of commitments and frameworks, where the main aim could be to cut down government red tape by 25%. Thereafter, Commit to simplifying and accelerate the procedures to register a property; Reduce stamp duty; Eliminate or privatize inspection and valuation of property; Reduce the time to declare bankruptcy; and Increase recovery rate of closing a business. Finally Kenya should also keep on the fight to establish a positive track record by adopting a policy of honouring both political and economic programs agreed with development partners.

4. Analyzing the Framework

The fact that FDI is positively correlated with economic growth is situated in growth theory that emphasizes the role of improved technology, efficiency and productivity in promoting growth (Lim, 2001). The potential contribution of FDI to growth depends strictly on the circumstances in recipient countries. The effect of FDI on economic growth is analyzed in the standard growth accounting framework.

The Model

This model will employ independent variables that are germane to economic growth. And therefore we will use an Ordinary Least Squares (OLS) Method in this study.

The independent variables to use therefore are as implied by the growth variables. Therefore that we will measure Aggregate FDI inflows as a linear relation to factors that impact directly on economic growth i.e. Openness of the economy to trade, Real domestic product, Annual Inflation Rates, and Human Capital

By reference to the familiar growth equation, we will take logs and differentiate the production function with respect to time to yield our Model for calculating FDI as below:

$$LN Y_t = \alpha_t + \alpha LN G_t + \lambda LN I_t + \gamma LN h_t + \delta LN \Pi_t + \varepsilon_t$$

Where: t is time

Y_t is the FDI inflow rate (FDI/GDP)

G_t represents the real gross domestic product (GDP)

I_t represents the Openness of the economy, ((Imports + Exports)/GDP)

h_{it} is the human skills capital stock ((Secondary + Tertiary Enrolment)/Population)

Π_{it} is the Inflation Rate, (INFL)

And

ε_t is an error term.

Description of variables

1. *GDP*: is used as a proxy of macroeconomic performance
2. *Openness to the Economy*: The ratio of trade (imports and exports) to GDP is used to capture FDI as is standard in the literature. In the growth accounting literature exports have been considered as an explanatory variable. FDI inflows are expected to result in improved competitiveness of host countries exports. As exports and investment increase, they will have a multiplier effect on GDP. Increased exports and investments may also generate foreign exchange that can be used to import capital goods.
3. *Human capital*: The importance of education to economic growth is proxied by the ratio of secondary and tertiary institution enrolment in the population.
4. *Inflation*: Inflation rate is included as a measure of overall economic stability of the country.

Data and Estimation

To achieve the stated objective of study, annual time series data of the variables were used. The data was sourced from the Kenya Central Bureau of Statistics (CBS), The World Bank's *World Development Indicators*, and own calculations.

The period covered by the study is 1980 – 2006. The data were tested on regression analysis by use of the Statistical Package for Social Services (SPSS).

Kenya Data: 1980–2006

Yr	FDI	GD P	LN of GDP	FDI Rate	LN of FDI Rate	Total Import	Total Exports	Openness of Economy	LN of Open	Sec.+ Tertiary	Population	Human Capital (H.C)	LN of H.C	Inflation (Infl)	LN of Infl
	<i>Million \$ (1\$=Ksh 70)</i>	<i>Rate</i>		<i>(FDI/ GDP)</i>		Million	Million	<i>(Imp+Exp) /GDP</i>		<i>Enrol</i>	<i>Estimates</i>	<i>(Sec.+ Tert)/ Pop</i>		<i>Rate</i>	
1980	40.97	5.3	1.67	5.49	1.70	19,181	9,753	55.4	4.01	446,257	16,667,015	2.7	0.99	12.8	2.55
1981	44.15	6.7	1.90	5.14	1.64	18,648	10,277	48.1	3.87	438,237	17,342,256	2.5	0.92	12.7	2.54
1982	23.74	2.4	0.88	2.46	0.90	18,006	10,915	42.8	3.76	459,028	18,035,228	2.5	0.92	22.4	3.11
1983	25.2	3.1	1.13	2.29	0.83	18,112	12,662	39.9	3.69	520,677	18,748,074	2.8	1.03	14.6	2.68
1984	10.75	0.9	-0.11	0.87	-0.14	21,944	15,096	43	3.76	544,892	19,482,212	2.8	1.03	9.1	2.21
1985	28.85	5.1	1.63	2.08	0.73	23,920	15,702	40.8	3.71	469,713	20,240,919	2.3	0.83	10.8	2.38
1986	35.38	5.6	1.72	2.19	0.78	26,758	19,159	40.5	3.70	490,362	21,021,253	2.3	0.83	10.5	2.35
1987	31.73	4.9	1.59	1.76	0.57	28,618	15,068	34.6	3.54	561,539	21,826,220	2.6	0.96	8.7	2.16
1988	43.39	5.2	1.65	2.13	0.76	35,303	18,354	37.7	3.63	585,781	22,656,620	2.6	0.96	12.4	2.52
1989	43.19	5	1.61	1.85	0.62	44,773	19,997	39.5	3.68	692,234	23,513,198	2.9	1.06	13.4	2.60
1990	41.1	4.5	1.50	1.54	0.43	50,913	24,647	40.4	3.70	684,889	24,396,807	2.8	1.03	15.6	2.75
1991	18.8	2.1	0.74	0.62	-0.48	52,918	30,677	39.3	3.67	681,845	25,307,735	2.7	0.99	19.7	2.98
1992	2	0.5	-0.69	0.06	-2.81	59,097	34,162	37	3.61	697,066	26,245,768	2.7	0.99	27.3	3.31
1993	6	0.2	-1.61	0.14	-1.97	101,128	72,504	55.8	4.02	596,172	27,214,465	2.2	0.79	46	3.83
1994	4.3	3	1.10	0.08	-2.53	115,080	83,414	52.1	3.95	686,490	28,211,185	2.4	0.88	28.8	3.36
1995	33	4.9	1.59	0.51	-0.67	155,168	93,124	55.3	4.01	686,067	29,237,055	2.3	0.83	1.6	0.47
1996	10.55	4.6	1.53	0.14	-1.97	168,486	113,926	54.7	4.00	726,420	30,291,870	2.4	0.88	9	2.20
1997	11.41	2.4	0.88	0.13	-2.04	190,674	114,459	49.8	3.91	753,224	31,375,313	2.4	0.88	11.2	2.42
1998	13.82	1.8	0.59	0.14	-1.97	197,789	114,445	45.7	3.82	762,572	32,486,922	2.3	0.83	6.6	1.89
1999	9.52	1.4	0.34	0.09	-2.41	206,401	115,406	44.2	3.79	809,073	33,626,200	2.4	0.88	5.7	1.74
2000	11.9	0.2	-1.61	0.11	-2.21	247,804	119,764	47.2	3.85	864,166	34,792,475	2.5	0.92	10	2.30
2001	5.31	1.2	0.18	0.04	-3.22	290,108	121,434	47.3	3.86	876,709	35,138,644	2.5	0.92	5.8	1.76
2002	27.63	0.5	-0.69	0.2	-1.61	257,710	131,394	40.9	3.71	933,639	36,138,744	2.6	0.96	2	0.69
2003	30.75	2.9	1.06	0.21	-1.56	281,844	136,709	40	3.69	1,042,083	37,183,924	2.8	1.03	9.8	2.28
2004	32.16	4.5	1.50	0.18	-1.71	364,557	159,048	41	3.71	1,104,463	38,277,856	2.9	1.06	11.6	2.45
2005	36.55	5.4	1.69	0.18	-1.71	443,101	209,918	45.4	3.82	1,120,146	39,423,264	2.8	1.03	10.3	2.33
2006	42.01	6	1.79	0.18	-1.71	512,483	228,180	45.2	3.81	1,240,875	40,406,412	3.1	1.13	14.5	2.67

Source: Central Bureau of Statistics (CBS), The World Bank's *World Development Indicators 2006*, and own calculations.

Results and Discussion

Regression

Variables Entered/Removed^d

Model	Variables Entered	Variables Removed	Method
1	Inflation, Openness of the economy, GDP, Human capital ^a	.	Enter

a. All requested variables entered.

b. Dependent Variable: FDI

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.592 ^a	.351	.233	1.3060

a. Predictors: (Constant), Inflation, Openness of the economy, GDP, Human capital

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20.288	4	5.072	2.974	.042 ^a
	Residual	37.525	22	1.706		
	Total	57.813	26			

a. Predictors: (Constant), Inflation, Openness of the economy, GDP, Human capital

b. Dependent Variable: FDI

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	10.737	10.000		1.074	.295
	GDP	.800	.260	.548	3.079	.005
	Openness of the economy	-2.845	2.165	-.252	-1.314	.202
	Human capital	-2.246	3.372	-.132	-.666	.512
	Inflation	.277	.369	.131	.751	.461

a. Dependent Variable: FDI

Since it is a known fact that for FDI to grow an economy it must first have been attracted into the country, we examine the determinants of FDI into Kenya.

The above results depict our model to be of the form:

$$Y_t = 10.737 + 0.8G_t - 2.845I_t - 2.246h_t + 0.277II_t$$

Where: t is time

- Y_t is the FDI inflow rate;
- G_t represents the real gross domestic product;
- I_t represents the Openness of the economy;
- h_{it} is the human skills capital stock;
- II_{it} is the Inflation Rate.

Interpreting the results displayed, we can show the relationship between FDI and the various economic growth variables that were chosen impact on economic growth in the following way:

From the results obtained in the model summary above, we can comfortably say that the economic growth (from the combination of the variables tested) affects 23.3% of total FDI. This is as explained by the Adjusted R-Squared which explains the proportion change in the dependent variable that can be attributed to the independent variable.

GDP growth has a positive relation with FDI ratio and is statistically significant to FDI as $t > 2$. Hence as the economy improves, FDI is attracted.

Openness to the economy is negatively related to FDI; therefore a more open economy will not really influence FDI inflows in Kenya but will exert a negative pressure on FDI inflows into Kenya.

Human Capital has a negative and statistically significant relationship with FDI. This is not expected. However, this means that FDI will tend to locate in those destinations that are able to supply skilled and disciplined labour force. Thus human capital in Kenya is not yet FDI inducing.

The positive relationship of the *inflation* coefficient suggests that the development within the macro economy is such that it encourages FDI inflows. This indicates that the various policy initiatives aimed at encouraging investors is yielding the expected results in Kenya.

5. Conclusion and Policy Implications

The objectives of this study were threefold: to identify the key factors that influence FDI decisions in Kenya and to explore the empirical relationship between FDI and economic growth in Kenya;

From the findings in the study the following can be inferred

1. The main determinants of FDI in Kenya are market size (proxied by GDP), stable macroeconomic policies and a level of human capital that is tolerable by investors.
2. The not significant relationship of human capital to overall economic growth suggests that there is a shortage of skilled labour in the Kenya.

We can therefore ascertain that from this findings that;

1. FDI in Kenya induces the nation's economic growth. Although the overall effect of FDI on the whole economy may not be significant, the components of FDI positively affect economic growth and therefore FDI needs to be encouraged.
2. Greater policy sensitivity towards the openness of the economy is needed so that the traded commodities will be beneficial to the economy as a whole.
3. There is need for guided training and integration of the human resources of the country to enable them to contribute positively to economic growth wherever they find themselves employed either with foreign or with indigenous firms and whichever sector they are in. The need for training high quality personnel in the country cannot be overemphasized.

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