

**THE IMPACT OF FOREIGN DIRECT INVESTMENT ON THE ECONOMIC
GROWTH OF LIBERIAN ECONOMY**

BY

PAYLAY MEMON HALAY

REG NO: D61/60888/2011

Dr. JOSIAH ADUDA

SUPERVISOR

**A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI**

NOVEMBER, 2012

DECLARATION

This project is my original work and has not been submitted for a degree in any other university.

Signed

Date

REG NO: D61/60888/2011

This project has been submitted for examination with my approval as the University Supervisor.

Signed

Date

Dr. Josiah Aduda

Lecturer, School of Business,

University of Nairobi

Moderator

Signed

Date

Chairman.....

Chairman, Department of Finance & Accounting University of Nairobi

DEDICATION

I dedicate this work to my Lord Jesus Christ who enables me to begin and complete my studies and also to my beloved daughter Helena Halay and her dearest mother and my loving family.

ACKNOWLEDEMENT

I wish to acknowledge the authority of the General Auditing Commission especially the former Auditor General Mr. John S. Morlue for affording me the opportunity to pursue an MBA program at the University of Nairobi.

I am absolutely grateful to my supervisor Dr. Josiah Aduda for his many contributions and guidance toward the successful completion of this research project and to all lecturers and Administrative Staff of the University of Nairobi for numerous supports.

ACRONYMS AND ABBREVIATIONS

CBL	-	Central Bank of Liberia
ER	-	Exchange Rate
FDI	-	Foreign Direct Investment
GDF	-	Global Development Finance
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
IFC	-	International Financial Corporation
INF	-	Inflation
LDC	-	Less Developed Country
MNC	-	Multinational Corporation
ODS	-	Official Development Assistance
OECD	-	Organization for Economic Corporation Development
RIR	-	Real Interest Rate
SPSS	-	Statistical Package for social sciences
TFP	-	Total Factor Product
UN	-	United Nations
UNCTAD	-	United Nations Conference Trade and Development
WB	-	World Bank
WTO	-	World Trade Organization

LIST OF TABLES AND GRAPHS

Table 4.3.1 Gross domestic product figures in millions of USD	21
Table 4.3.2 foreign direct investment figures in millions of USD	22
Table 4.3.3 Pearson correlation between dependent and independent variables for the study	23
Table 4.3.4 Independent sample test statistics	24
Graph 4.4.1 Show the relationship between FDI and GDP growth	25
Graph 4.4.2 Show the relationship between independence and dependent variables	26

TABLE OF CONTENTS

DECLARATION	ii
DEDICATION	iii
ACKNOWLEDEMENT	iv
ACRONYMS AND ABBREVIATIONS	v
LIST OF TABLES AND GRAPHS	vi
ABSTRACT	x
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the study	1
1.2 Research Problem	5
1.3 Objective of the study	6
1.4 Value of the Study	6
CHAPTER TWO	8
LITERATURE REVIEW	8
2.1 Introduction	8
2.2 Theories on FDI	8
2.3 Neo-Classical Microeconomic theory	8
2.4 Theory of Comparative Advantage	9
2.5 Imperfect Market Theory	9
2.6 Product Cycle Theory	9
2.7 Economic growth Theories	10
2.8 Classical Growth Theories: Adam Smith and David Ricardo	10

2.9	Endogenous Growth Theory	11
2.10	Benefits of foreign direct investment	12
2.11	Growth and Employment	12
2.12	Employment Generation	12
2.13	Technology and Know How	12
2.14	Infrastructure Development.....	13
2.15	Empirical Studies	13
2.16	Conclusion on Literature Review.....	16
CHAPTER THREE		17
RESEARCH METHODOLOGY		17
3.1	Introduction	17
3.2	Research Design.....	17
3.3	Target Population	17
3.4	Sample.....	17
3.5	Data Collection.....	18
3.6	Data Analysis	18
3.7	Model Specification	18
CHAPTER FOUR.....		21
4.0	Data Presentation and Analysis.....	21
4.1	Introduction	21
4.2	Data presentation.....	21
4.3	Descriptive Analysis	21
4.4	Summary Interpretation of Findings	26

SUMMARY, CONCLUSION AND RECOMMENDATION	28
5.2 Conclusion.....	29
5.3Policy Recommendations	30
5.4 Limitations of the study.....	31
5.5Suggestions for Further Research	31
REFERENCE.....	33
APPENDIX I: EVERY YEAR FDI, GDP, INFLATION INTEREST RATE AND EXCHANGE RATE	37

ABSTRACT

Foreign direct investment (FDI) is that investment whereby a firm based in one country locates or acquires production facilities in other countries. Foreign direct investment is important to the future development of every country especially African nations, as it is a means of increasing the capital available for investment and the economic growth needed to reduce poverty and raise living standards in any given country. Foreign direct investment plays a vital role in the up gradation of technology, skills and managerial capabilities in various sector of the economy.

Appropriate structure put in place by the Government will go a long way to achieve the spillovers foreign direct investment produces. The research showed significance benefits that foreign direct investment brings to host country. The main purpose of this study was to establish the relationship between foreign direct investment and economic growth in Liberia. This research also seeks to provide awareness among policymaker, institutional, multinational and local investors about FDI operations in Liberia. The empirical finding of this research project proved that foreign direct investment has a positive and weak relationship with GDP growth rate in Liberia.

Foreign direct investment inflows to Liberia have been exponentially increasing over the period and majority of these inflows are concentrated within the extractive industry. Formidable effort is required to transform the foreign investment that had been attracted to Liberia in order to positively affect the lives of the ordinary Liberians. The study analyzed and presented findings on foreign direct investment ranging from 2003 to 2011 annual year. Proper monitoring, supervision and realistic policies controlling foreign investment in Liberia will open the way for the attracted foreign investment to improve the living standard of the ordinary Liberians

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

There is increasing recognition that understanding the forces of economic globalization requires looking first at foreign direct investment (FDI) that is, when a firm based in one country locates or acquires production facilities in other countries. (Bruce A. Blonigen 2006). Foreign direct investment is important to the future of development of every country especially African nations, as it is a means of increasing the capital available for investment and the economic growth needed to reduce poverty and raise living standards in the continent. In addition, it can contribute to sustainable economic development, as it can result in the transfer of new technologies, skills and production methods, provide access to international markets, enhance efficiency of resource use, reduce waste and pollution, increase product diversity and generate employment (Loots, 1999; Ngowi, 2001; UNCTAD, 1997).

However, in the absence of regulations governing natural resource extraction, or when they are weak or poorly enforced, increased openness to foreign investment can accelerate unsustainable resource use patterns. The ability of developing countries to attract FDI, maximize the associated benefits and minimize the risks depends on the effectiveness of their policy/institutional frameworks and institutions (Wilhelms, 1998; Pigato, 2001). The determining factor for a particular firm to establish production facilities abroad is the prospect of earning higher profit which induces firms to invest abroad, primarily because of lower labor costs. Traditional theories on trade and investment assumed that factors of production, such as labor and capital, were not internationally traded. However, in reality, factors are internationally mobile and at least since the nineteenth century, international labor movement and international investments have been very important in the global economy (Jayasuriya and Weerakoon, 2000).

FDI is also viewed as a way of increasing the efficiency with which the world's scarce resources are used. A recent and specific example is the perceived role of FDI in efforts to stimulate economic growth in many of the world's poorest countries. Partly this is because of the expected continued decline in the role of development assistance (on which these countries have traditionally relied heavily), and the resulting search for alternative sources of foreign capital.

More importantly, FDI, very little of which currently flows to the poorest countries, can be a source not just of badly needed capital, but also of new technology and intangibles such as organizational and managerial skills, and marketing networks. FDI can also provide a stimulus to competition, innovation, savings and capital formation, and through these effects, to job creation and economic growth. Along with major reforms in domestic policies and practices in the poorest countries, this is precisely what is needed to turn-around an otherwise pessimistic outlook. (WTO, 1996)

According to Global Development Finance (2008) and Economic Survey (2008), net flows of FDI to developing countries rose from 367 billion in 2006 to 471 billion in 2007. These inflows amount to 25 percents of global FDI inflows. Without the present of foreign capacity, it would be difficult for developing countries to generate huge capital from their domestic savings and even if they were capacity of generating initial investment capital it would have also been difficult to import the necessary technology from abroad since transfer technology to firms with no previous experience of using it is difficult and risky (Duce et-al 2003).

Economic Growth refers to an increase in the productive capacity of an economy as a result of which the economy is capable of producing additional quantities of goods and services. Normally our standard of living is measured by the quantity of goods and services available to us so that economic growth is synonymous with an increase in the general standard of living (*Noel, 2012*). Explaining economic growth is one of the fundamental questions in economics and has generated a large body of research. Early economists stressed the importance of land (natural resources) and labor (human resources) in economic growth. In the *Wealth of Nations (1776)*, Adam Smith began with “original state of things, which precedes both the appropriation of land and the accumulation of (capital) stock.” Neoclassical model of economic growth, pioneered by Robert

Solow (1956), gives us some insight into how the capital accumulation and a technological change affect the economic growth. The importance of technology for economic growth provides an important link between FDI inflows and host country economic growth. It is theoretically straightforward to argue that inflows of FDI have a potential for increasing the rate of economic growth in the host country Romer (1986, 1990) and Lucas (1988).

Despite the straightforwardness of the argument, empirical evidence on a positive relationship between FDI inflows and host country economic growth has been elusive. When a relationship between FDI and economic growth is established empirically, it tends to be conditional on host country characteristics such as the level of human capital, De Mello (1999) and Borensztein et al. (1998). The difficulty in showing a positive effect from FDI on economic growth provides a strong incentive for further empirical studies. Neo-classical models of economic growth only allow FDI to have a level effect on growth due to diminishing returns to capital. However, the endogenous growth theory provides a framework for studying the link between FDI and economic growth, making it possible to take the characteristics of FDI into account and thereby improve the chances of confirming the theoretical relationship by empirical evidence.

Foreign direct investment concerned with fundamental factors such as stable macroeconomic and political situation as well as credibility of policy reforms. A stable and sustainable macroeconomic environment boosts the confidence of private investors. Reduction in debt burden is also critical not only for sustaining both external and fiscal balance but also for engendering confidence to encourage private sector investment (Dunning,1993). On this basis, the study is expected to produce a positive relationship between foreign direct investment and economic growth in Liberia.

There is growing investor interest in Liberia, particularly in agriculture, construction, the extractive industries and tourism. UN sanctions were lifted on timber exports in 2006 and on diamond exports in early 2007. Liberia is now Kimberley Process compliant. The removal of sanctions opened the door to investment activity in those sectors. Liberia has demonstrated consistent annual progress since its 2007 debut in the International Finance Corporation (IFC) . The National Investment Commission has recorded over \$19 billion in new foreign investment since 2006, primarily in the extractive industries, and local business registration also continues to rise. (NIC, 2011)

Before the end of the Second World War, the only important foreign investor in Liberia was the American “Firestone Tire and Rubber Company”, which in 1926 had obtained enormous concession agreement from the Government of Liberia. During the 1926-1951 periods, the independence on the only dealing foreign investment slowly increased and was finally complete.

For this reasons, the country became informally known in the period as the “firestone Colony”. This change when iron ore production begun in 1951. The mine was exploited by another U.S. company, the “Republic Steel Company”. Following 20 years, the highly attractive investment facilitated offered by the Liberian Government, the abundance of natural resource and political and social stability caused an invasion of foreign investors. Since the arrival of the foreign investors Liberia changes tremendously. Liberia foreign investment boom was at the zenith during the 1960s. As a result, the country grew spectacularly and with a two digit rate the country was shortly belonged to a small group of countries with the fastest growing economies in the world. (Van Der Kraij, 1983)

In 1944, President Tubman instituted what was known as the Open Door Policy in an attempt to stimulate the Liberian economy. His invitation to foreign enterprises and his relentless promoting put Liberia on the move. During the 1950s Liberia had the greatest percentage increase in per capita Gross National Product in the world and was exceeded only by Japan in real GNP growth for the same period. (Marinelli, 1964). By the end of 2000 the Liberian GDP had recovered to half of the pre-war levels, but the economic structure had changed significantly. Iron ore production had stopped completely and the rubber sector accounted for over half of export income. From 2000 to 2002, forestry represented the country’s most important economic activity, responsible for 50–60 per cent of the nation’s foreign exchange and accounted for 26 per cent of GDP in 2002. International Monetary Fund (2003) stated that the near term growth prospects of the Liberian economy would rely primarily on timber products from the regions unaffected by the conflict and warned that without effective control mechanisms the viability and long-term sustainability of the resources would be endangered.

The economy of Liberia has experienced rapid growth for the period between 2006 to 2011 respectively. Growth achieved in 2010 was 6.1%, up from 4.6% in 2009, which was highly driven by an increase in exports and foreign direct investment (FDI). Growth rate attained in 2011 was 7.3% with an estimated projection of 8.9% in 2012. The rise in exports was due to an increase in commodity prices, particularly rubber, palm oil and minerals. In 2010, the government also began receiving royalty payments (of USD 1.57 million) from the extractive industries sector and these are projected to grow to USD 30 million by 2015. Liberia’s economic structure is highly dependent on agricultural productivity. Agriculture contributes approximately

77% of the country's GDP and employs almost 70% of the total working population. The major crops include rubber, coffee, cocoa, sugarcane, rice and timber. The underdeveloped industrial sector employs 8% of the labor force and accounts for 5.4% of the GDP. Major industries include rubber processing, timber and diamond. Service sector employs 22% of the working population and contributes 17.7% to the national production. (Economy watch, 2010)

1.2 Research Problem

Foreign direct investment plays an important role in fostering economic growth and development. While it is known to bring much needed capital for growth and development efforts, it also bring with it skills and new technology. FDI stimulates domestic investment, promotes economic growth, creates employment opportunities and promote transfer of new technology. For most countries in south Sahara Africa, whose economy has recovered from a long period of stagnation, FDI inflows are needed to create growth and development. Several FDI could improve host country industrial development effort and their competitiveness by bringing into them some desirable attributes such as best practices in production, new skills and training, leading-edge or new technology, new managerial and marketing knowledge linkage formation.(World Bank, 2006)

There is lot of controversy on the link of foreign direct investment and economic growth rate. Over the years, Liberia has extracted large stock of foreign direct investment in the tone of 10billion as provided by National Investment Commission in 2011. Frazer Lanier et-al (2011) examined the relationship between FDI and improved living standard in the Liberia economy. The researchers designed major case studies on leading FDIs in Liberia from different sectors of the economy. The study found that job creation and industrial economic diversification are challenged by the structural characteristics of the sectors, low human capacity level and high energy costs are majored contributing factors for the downturn. The study showed that inasmuch FDI has provided certain level of jobs; they have so far not been of a scale that addresses the extremely high unemployment rate in the country. Furthermore, official development assistance constitutes major source of foreign capital to Liberia, these fundings by all standards should translate into increase growth. An assessment on ODS to Liberia showed that Liberia was backward in the careful management of donor findings Charles Mutasa (2008). This raises concern that bulk of the financial aid and revenue generated from FDI are not being

appropriately used in development project and this brings out issues of corruption, asset misappropriation and gross embezzlement (Lemi, 2005).

In this regard, this study will be designed to draw the relationship between foreign direct investment and economic growth in Liberia so as to determine the impact of foreign resources in the economic activities of Liberia. In addressing this relationship, we shall answer the research question:

Does foreign direct investment support economic growth in Liberia? Fundamentally, the level of foreign direct investment inflows in Liberia does not translate into improved level of human development as Liberia stayed remains one of the poorest nations in the world.

1.3 Objective of the study

To establish the relationship between foreign direct investment and economic growth in Liberia

1.4 Value of the Study

The relevance of the study is to create awareness among interested readers and authorities about the importance of foreign direct investors (FDI) inflow within the economy of Liberia. Now that the world economy, through technological advancement has become a global village, information is available and consumers are aware of development in the world. The research will provide better understanding of trends and prospects of foreign direct investment activities in the country. FDI is an area of key concern to most developing countries as some studies have proven that it contributes positively to the economic growth and development of a country.

Policymakers and development partners would benefit from the result of the study as they are more concerned with the country growth oriented strategies and creativity and seeking principles for sustainability of the economy. The research methodology adopted for this study will be realistic and helpful to other researcher in knowing how to generate particular data and how to analyze these data. Moreover, the information and the procedures that will be use in this study will serve as a fundamental basic for other academic and institutional researchers in conducting further studies on the economic growth of Liberia as FDI is concerned. The empirical result of the investigation will also raise international awareness to both bilateral and multilateral

institutions as well as donor communities to know the actual situation in Liberia and adopt necessary recommendations as the study will bring forward.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes literature on the topic under consideration: The impact of FDI on the economic growth of the Liberia economy. This relates to work that had been done by other scholars. The chapter is organized as follows: Theories on economic growth, theories and importance of FDI and empirical studies.

2.2 Theories on FDI

2.3 Neo-Classical Microeconomic theory

Aggarwal (1984) the flow of capital from one country to another is determined solely by the level of interest rate. Literature has provided that neo classical microeconomic theory was the most widely use theory to explain the reasons of foreign direct investment (Dunning 1993). The theory clearly states that the movements of capital between cross borders are basically caused by disparity in interest rate level exist between countries. Cockcroft Riddell(1991) provides that the future flow of investments are positively related to the package of inducement that may influence the expected rate of return; the security of the investment, the scope and speed with which corporations are able to disinvest. The tax regime; investment code and guidelines; and overall macroeconomic policies are the several elements affecting foreign direct investment.

Iverson (1953) -capital flows with ease from countries with lower rate of return to countries that have relatively higher rate of return under a condition of perfect competition. The theory came under heaved attack by (Hymer, 1976) on the ground that it did not explain the role of Tran – National Corporation in capital mobility because it subjected itself to explaining how and where firms decide to obtain the capital needed to finance their global plans. Another researcher in support of Iverson argument also provides that the major determinant of foreign direct investment in developing countries is the expectation of higher profits by firms. This view support the wide spread notion of many local business practitioner in Liberia; for them, Multinational businesses choose country such as Liberia for higher gain base on the weak investment environment in the country.

2.4 Theory of Comparative Advantage

Comparative advantage theory is an argument that was advanced by David Ricardo in favor of free trade among countries and specialization among individuals. Ricardo argued that there is mutual benefit from trade even if one party is more productive in every possible area than its trading counterpart as long as each concentrates on the activities where it has a relative productivity advantage (Ricardo, 1772).

Multinational businesses have generally increased over time. These growths are due to the heightened realization that specialization by countries can increase production efficiency. When a country specializes in some products, it may not produce other products, so trade between countries is essential (Madura, 2008).

2.5 Imperfect Market Theory

Countries differ with respect to resources available for the production of goods. Yet, even with such comparative advantages, the volume of international business would be limited if all resources could be easily transferred among countries. If markets were perfect, factor of production (except land) would be mobile and freely transferrable. The unrestricted mobility of factors would create equality in cost and returns and remove the comparative cost advantage, the rationale for international investment. However, the real world suffers from somewhat from imperfect market conditions where factors of production are somewhat immobile. Because markets for the various resources used in production are “imperfect” firms often capitalize on foreign country’s resources. Imperfect market provides an incentive for firms to seek out foreign opportunities (Jeff Madura, 2008). Due to structural market imperfections, some firms enjoy advantages vis-à-vis competitors. These advantages (including brand name, patents, superior technology, organizational know-how and managerial skills) allow such firms to obtain rents in foreign markets that more than compensate for the inevitable initial disadvantages (Hymer, 1960).

2.6 Product Cycle Theory

One of the more popular explanations as why firms evolve into MNCs is the product cycle theory. According to this theory, firms become established in the home market as a result of some perceived advantage over existing competitors, such as a need by the market for at least one more supplier of the product. Because information about market and competition is more readily available at home, a firm is more likely to establish itself first in its home country. Foreign demand for the firm’s product will initially be accommodated by exporting. According to this

theory, as time passes, the firm will feel the only way to retain its advantage over competition in foreign countries is to produce the product in foreign markets, thereby reducing transportation cost. (Jeff, 2008)

2.7 Economic growth Theories

Economic growth is the increase in the amount of the goods and services produced by an economy. It is usually measured by changes in the Gross Domestic Product (GDP) (Dolan et-al 2008).

2.8 Classical Growth Theories: Adam Smith and David Ricardo

In his book *The Wealth of Nations*, Adam Smith believed that by pursuing his own interest, an individual “frequently promotes that of the society more effectually than when he really intends to promote it” (Smith, 1864, p. 184). This means in the broader sense that the economy works like a self-regulating system, so that state intervention in the economy will hamper this natural process. Adam Smith expounded his ideology of the “invisible hand” that “the private interests and passions of individuals naturally dispose them to turn their stock towards the employments which in ordinary cases, are most advantageous to the society. Without any intervention of law, therefore, the private interests and passions of men naturally lead them to divide and distribute the stock of every society among all different employment carried on in it, as nearly as possible in the proportion which is most agreeable to the interest of the whole society” (Smith, 1864, pp. 260-261). Adam Smith grouped the labourers as productive and unproductive workers. The productive workers *are* employed in the production sector (e.g. agriculture, manufacturing and handicraft) and produce revenue (profit and rent). The unproductive workers are mainly in the service sector (e.g. officials, professors, politicians, actors and servants) and are maintained by the revenue produced in production sector (Smith, 1864).

According to Ricardo’s doctrine, profit finances investment because “no one accumulates but with a view to make his accumulation productive, and it is only when so employed that it operates on profits. Without a motive, there could be no accumulation. The farmer and manufacturer can no more live without profit. Their motive for accumulation will diminish with every decrease of profit, and will cease altogether when their profits are so low as not to afford them an adequate compensation for their trouble, and the risk which they must necessarily encounter in employing their capital productively” (Ricardo, 1821). Therefore, growth rate of capital stock is positively related to profit rate and negatively related to wage costs. Financed by profit, the investment is directly associated with the growth of agricultural sector and thus the national product.

The agricultural sector includes also those parts of the industry and handicraft sector, which produce tools and machines for agriculture; here, the indirect employment of agriculture is active.

In the view of Ricardo, wages are regulated by the increase of capital flow. “In the natural advance of society, the wages of labor will have a tendency to fall, as far as they are regulated by supply and demand; for the supply of laborers will continue to increase at the same rate, whilst the demand for them will increase at a slower rate until the capital becomes stationary, when wages also would become stationary, and be only sufficient to keep up the numbers of the actual population” (Ricardo, 1821a, pp. 95-96). Interest is regulated chiefly by the profits that may be made by the use of capital. A low rate of interest is a symptom of a great accumulation of capital; but it is also a symptom of a low rate of profits, and of advancement to a stationary state; at which the wealth and resources of a country will not admit of increase” (Ricardo, 1821).

2.9 Endogenous Growth Theory

Endogenous growth is long-run economic growth at a rate determined by forces that are internal to the economic system, particularly those forces governing the opportunities and incentives to create technological knowledge. In the long run the rate of economic growth, as measured by the growth rate of output per person, depends on the growth rate of total factor productivity (TFP), which is determined in turn by the rate of technological progress. The neoclassical growth theory of Solow (1956) and Swan (1956) assumes the rate of technological progress to be determined by a scientific process that is separate from, and independent of, economic forces. Neoclassical theory thus implies that economists can take the long-run growth rate as given exogenously from outside the economic system.

Robert Lucas pointed out that international wage differences and migration are difficult to be explained with neoclassical theory. If the same technology was available globally, skilled people with human capital would not move from developing countries, where human capital is scarce, to developed countries, where human capital is abundant, as these people do now (cf. Romer, 1994, p. 11). Moreover, the neoclassical model implies that substantial international capital would move from developed countries, with high capital-labour ratios, to developing countries, with low capital-labour ratios. However, most developing countries attract no net capital inflows, and many developing countries even experience domestic capital flight. Neoclassical theorists assume that technological discoveries are global public goods, so that all people can use new technology at the same time. However, because individuals and firms control information flows, patent protection restricts use by rivals, and charge prices for others to use the technology, new growth economists assume a temporary monopoly associated with innovation. Neoclassical economists emphasize capital formation.

New growth economists stress external economies to capital accumulation that can permanently keep the marginal product of physical or human capital above the interest rate, and prevent diminishing returns from generating stagnation (Grossman, Elhanan, 1994).

2.10 Benefits of foreign direct investment

The current financial and economic crises have reanimated the debate on the importance of Foreign Direct Investment (FDI) for economic growth and poverty reduction in developing countries, especially in Africa. Many economists agree on the fact that the current financial crisis may have stronger negative repercussions on economic growth in Africa because of the potential reduction in foreign capital flows. (Issouf Soumaré et-al 2009).

2.11 Growth and Employment

Productive FDI usually brings long lasting and stable capital flows as they are invested in long term assets. These funds are introduced into a country's economy contributing to the aggregate demand of the economy, and therefore to the growth of the economy of a country. Companies within the country, due to the competition brought in by FDI, tend to become more productive to effectively counter the threat of the competitor from abroad. Higher productivity of companies contributes to the growth of a country's economy (Baracaldo 2005).

2.12 Employment Generation

Employment generation is another positive effect of FDI. As a country becomes more productive, its competitiveness increases as has been referred by several works, including Porter in its book "The Competitive Advantage of Nations". With increases competitiveness, employment is created and the introduction to the world economy is more feasible (Castilla, 2005).

2.13 Technology and Know How

FDI allows for the transfer of technology and specialized knowledge which in turns favors and increase in productivity (Ramírez , 2006). The significance of FDI is that such investments in the host country advance technology, management practices and assured markets. In due course there is a technology transfer as the local workforce gains knowledge of the manufacturing processes and management practices. The value added in these industries is a contribution to GDP and foreign exchange earnings.

Therefore FDI contributes to foreign exchange earnings, employment creation and increases in incomes, especially of skilled and semi-skilled workers in these industries.(Nimal Sanderantne, 2011)

2.14 Infrastructure Development

One of the many areas in which foreign direct investment can benefit a country or any entity, for that matter, is that of development of infrastructure. It has been observed over the years, that a lot of countries as well as other recipients of direct investment from overseas entities have used that money in order to develop the infrastructural facilities at their disposal. All the various types of infrastructure that are at the disposal of a country like health or education may enjoy the benefit of foreign direct investment (Economy Watch, 2010).

2.15 Empirical Studies

Many empirical studies provide that FDI is significant in that it provides source of capital and support domestic private investments. (Chen and Demurger, 2002) found that FDI contribute to total factor productivity and income growth in host economy, over and above whatever domestic investment would trigger. The researchers argue that policies that promote indigenous technological capacity, such as education, technical training and Research and Development (R & D) increase the aggregate rate of technology transfer from FDI and that export promoting trade regime are essential foundation for positive FDI impact. The study conducted by Borenstein, De Gregorio, and Lee (1998) using data on FDI received by developing countries tested the effect of FDI on the economic growth in across countries regression framework showed a positive relationship between FDI and economic growth.

Loesse Jacques ESSO (2010) conducted a causal study to establish the relationship between foreign direct investment and economic growth in case of ten Sub-Saharan African countries which include Liberia and nine other countries s. The study considered two recent econometric procedures which are the Pesaran et al. (2001) approach to cointegration and the procedure for non-causality test popularized by Toda and Yamamoto (1995). The result of the study showed that there is a long-run relationship between foreign direct investment and economic growth in Liberia, Angola, Cote d'Ivoire, Kenya, , Senegal and South Africa. In addition, the long-run effect of foreign direct investment on growth is positive and statistically significant in Angola

and Cote d'Ivoire, but it is not significant in Kenya. Moreover, GDP impacts FDI significantly and positively in Senegal and South Africa. Conclusion about causality is that foreign direct investment significantly causes economic growth in Angola, Cote d'Ivoire and Kenya. In view of these findings, the conventional view which seems to suggest that the direction of causality runs from FDI to economic growth is confirmed in Angola, Cote d'Ivoire and Kenya, but not in Liberia and South Africa where growth causes FDI inflows. Frazer Lanier et-al (2011) study provided slight relationship between FDI and improved living standard in the Liberia economy. The researchers designed major case studies on leading FDI in Liberia from different sectors of the economy. The study found that job creation and industrial economic diversification are challenged by the structural characteristics of the sectors, low human capacity level and high energy costs are majored contributing factors for the downturn. The study showed that inasmuch FDI has provided certain level of jobs; they have so far not been of a scale that addresses the extremely high unemployment rate in the country.

Hansen and Rand (2006) re-examine the causal links between FDI and economic growth in 31 developing countries over 31 years (1970-2000). They used bivariate vector autoregressive models for GDP and FDI ratios. They find a strong causal link between FDI and GDP, even in the long run. They also find that GDP Granger-causes FDI, but find no impact on the long-run level of the ratio of FDI over GDP. Moreover, Carkovic and Levine (2005) study the relationship between FDI and economic growth for 72 countries. They find no support for the claim that FDI per se accelerates economic growth. Therefore, the findings in Hansen and Rand study contrast with that of Carkovic and Levine study on FDI and economic growth . With these mixed views on the causality link between FDI and economic growth, some researchers have chosen to analyze the causal relationship between FDI and growth in specific economic sectors or particular regions.

Kimotho A. Musua (2010) assessment on the relationship of FDI and economic growth in Kenya found that there was a strong and significant relationship that exists between FDI and economic growth in Kenya. His study justified that the positive relationship depicts that there is direct proportionate relationship which exist between FDI and economic growth. The researcher further provided that both inflation and trade term play important role in explaining changes in growth

and foreign direct investment. Accordingly, improve inflation rate and better term of trade to foreign investors would go long way in improving the level of foreign direct investment and economic growth. Unlike Kimotho's study that found a direct and strong relationship between FDI and economic growth for the case of Kenya economy, study investigated by (Singer, 1950; Griffin, 1970) found a negative relationship between FDI and economic growth for developing nations. The common sense of these studies was that FDI was concentrated on low priced primary export to develop countries and had a negative impact on the overall growth pattern.

In previous studies on FDI and its effect on output and growth, many economic researchers have concluded that there are positive effects of foreign direct investment on economic development. There have been several studies concerning FDI as an engine for growth in East Asia. Kim and Hwang (2000) study the role of FDI in South Korea's economic growth. They state that a stable inflow of foreign investment could help South Korea to recover from the severe financial crisis of the 1990s but that the country still fears that increasing FDI will lead to foreign control over the domestic economy. They conclude that FDI and the presence of MNC's may help a country in crisis to overcome its difficulties and their empirical results show that FDI inflow lowers the odds of a currency crash. Chan (2000) studies the relationship between FDI and economic growth in Taiwan. He focuses on whether movements in FDI can be used to predict movements in economic growth.

Kim and Hwang (2000) examine whether FDI in Korea has positive effects on productivity in manufacturing industries. In addition, they investigate whether FDI plays a role in preventing currency crisis. In this review, emphasis will be placed on the FDI and economic productivity of manufacturing industries leaving out the other factor. In this regards, Kim and Hwang investigation of the productivity effects of FDI in Korea adopted the total factor productivity (TFP) as a measure of productivity in manufacturing industries. In their study, TFP was calculated as a residual in the conventional growth accounting framework. Growth in TFP was assumed to be a function of the growth rates of the FDI stock and the royalty stock, which is used as a proxy for imported technology from foreign countries. They use a random-effects model with instruments to avoid possible endogeneity between productivity effects and the independent variables. They found that FDI stock has a positive but insignificant effect on TFP growth in manufacturing industries.

2.16 Conclusion on Literature Review

Caves (1996) considers that the efforts made by various countries in attracting foreign direct investments are due to the potential positive effects that this would have on economy. FDI would increase productivity, technology transfer, managerial skills, knowhow, international production networks, reducing unemployment, and access to external markets. Borensztein (1998) supports these ideas, considering FDI as ways of achieving technology spillovers, with greater contribution to the economic growth than would have national investments.

The relationship between FDI and economic growth has been extensively discussed by many scholars. Van Der Kraij (1983) study on Liberia's economic growth and development arose a motivated interest in the importance of foreign direct investment and private sector development. However, the capacity of the Government of Africa oldest republic to effectively deal with foreign investors it has invited and to supervise the resulting investments was a matter of great concern. Van's study revealed an unrelated effect between foreign direct investments and improve standard of living in the Liberian economy. An assessment on ODS to Liberia showed that Liberia was backward in the careful management of donor findings Charles Mutasa (2008). This raises concern that bulk of the financial aid and revenue generated from FDI are not being appropriately used in development project and this brings out issues of corruption, asset misappropriation and gross embezzlement (Lemi, 2005).

In my view, research on FDI and economic growth would generally require considering a sizable data in order to derive as more reliable and conclusive finding worth generalizing. A positive trend in FDI maintains over a long run period could contribute to economic growth once the right policy and infrastructures are being instituted by policymaking. The pool of multinational institutions seeking new market in Liberia for the last eight year has been overwhelming. In real term, such high increase of foreign capital inflow should translate in to increase production and high standard of living.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter brings forth the way by which the research study will be conducted. It is therefore organized in the following manner: Section 3.2 outlines the research design, section 3.3 looks at the targeted population, section 3.4 considers the sample of the study, section 3.5 focuses on data collection, section 3.6 discusses the analysis of data and section 3.7 shows the model specification.

3.2 Research Design

The research adopted a causal design, as this design shows cause and effect relationships between variables. By the use of this approach the relationship between FDI and economic growth within the Liberian economy was established. The causal design is best preferred for the study as it will reveal how the explanatory variables (independent variables) will coincide with the dependent variable. Furthermore, using this method will assist in establishing how the value of independent variables will produce the value of the dependent variable.

3.3 Target Population

The study primarily focused on FDI and economic growth in Liberia whilst economic growth encompasses the conglomeration of all sectoral growth. Thus, the target population for the study will be the GDP figures which is a measure of economic growth. In the case of foreign direct investment, the study looks at the amount contributed by foreign companies within each year.

3.4 Sample

The sample data utilized for the purpose of this study was range between the periods 2003 to 2011. A sample of nine consecutive years is sufficient to be representative for this investigation. As a result, findings generated by the study can be generalized and used for national decision making.

3.5 Data Collection

For the purpose of this research project, data was obtained from many sources such as Central Bank of Liberia (CBL) and other international body reports. These multiple sources according to Yin (1994) and stake (1995) allow the convergence of lines of inquiry and the triangulation of evidence. By using a case study strategy, as suggested by Dyer and Wilkins (1991), the study will focus on a particular context, and describes and analyzes one particular phenomenon richly and comprehensively. The research will heavily rely on secondary data. These data will be used to establish the relationship between FDI and foreign direct investment in Liberia.

3.6 Data Analysis

From the data that was collected, multiple regression analysis was used to establish the correlation between GDP and Foreign Direct Investment over the stated period. Data is presented using charts and line graphs. These methods of data presentation are preferred because they complement each other in the research operation to come out with relevant and comprehensive information. The following four assumptions are generally applied when using the regression model: Linearity of the relationship between dependent and independent variables

Independence of the errors (no serial correlation)

Homoscedasticity (constant variance) of the errors Versus the predictions (or versus any independent variable)

Normality of the error distribution

If any of these assumptions is violated (i.e., if there is nonlinearity, serial correlation, heteroscedasticity, and/or non-normality), then the forecasts, confidence intervals, and economic insights yielded by a regression model may be (at best) inefficient or (at worst) seriously biased or misleading.

3.7 Model Specification

The basic concern of the study is to establish the relationship between economic growth which is measure by GDP thus representing the dependent variable for the study whilst FDI, inflation rate, exchange rate, and real interest rate representing the independent variables of the study. The general multiple regression model which the study adopted is provided below:

$$y_i = \alpha + \beta_1 x_{1i} + \beta_2 x_{2i} + \epsilon_i$$

Where α is the intercept, $\beta_1\beta_2$ is the slope, and ϵ_i is the error term, which picks up the unpredictable part of the response variable y_i . The error term is usually posited to be normally distributed. The x 's and y 's are the data quantities from the sample or population in question, and α and β are the unknown parameters ('consants') to be estimated from the data.

In this research however, the parameters will have the following definitions of expressions:

α = Regression Coefficients (to be estimated) measures how much units of GDP would be changed with a unit change in FDI.

β = Regression Coefficients (to be estimated) measures how much units of GDP would be changed with a unit change in other components of the economy. Most applications of linear regression models assume that all data used to construct the model and all data input to the model in production are accurate. The regression model was best preferred for the study in that it was used to show précised relationship between the underlying variables being considered for this study. The model was used to show the cause and effect in the movement of the independent and dependent variables.

The research will make use of the Statistical package for Social Sciences (SPSS) to estimate the result of the correlation between the variables.

Model to be used to show the relationship between the variables is formulated below:

$$Y = f(X, INF, ER, RIR)$$

Y = Output (GDP)

X = FDI

INF= Inflation rate

ER= Exchange rate

RIR = Real interest rate

GDP = Gross Domestic Product

The regression equation for this study will be re-stated as shown below:

$$\text{GDP} = \alpha + \beta_1 \text{FDI}_1 + \beta_2 \text{INF}_2 + \beta_3 \text{ER}_3 + \beta_4 \text{RIR}_4 + \epsilon$$

Where:

GDP= Y= out put

α = constant

FDI= foreign direct investment

INF= inflation rate

ER= exchange rate

RIR= real interest rate

The concern of this study is to establish the relationship between the dependent variable which is represented as GDP and explanatory variables represented by FDI, inflation rate, exchange rate and real interest rate. The model to establish the relative strength of the relationship between the variables is provided here below:

$$Y = f(\text{FDI}, \text{INF}, \text{ER}, \text{RIR})$$

$$Y = f(\alpha \text{FDI}_{t1}^{a1} \text{INF}_{t2}^{a2} \text{ER}_{t3}^{a3} \text{RIR}_{t4}^{a4})$$

The hypothesis provided for the study is:

Ha1: There is a relationship between FDI and GDP in Liberia

Ho1: There is no relationship between FDI and GDP in Liberia

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This section presents the data collected for analysis, summary and interpretation of findings and data presentation. This was done using descriptive statistics, line graphs and correlation analysis relating to the study. The analysis for the study was conducted in establishing the relationship that holds between FDI and economic growth in Liberia.

4.2 Data presentation

4.3 Descriptive Analysis

Table 4.3.1 Measurable data for the study presented in millions of USD and percentage from the period of 2003 to 2011

FDI	GDP	INFLATION RATE	INTEREST RATE	EXCHANGE RATE
1587	372	10.4	17.06	59.38
1095.9	381.5	7.8	18.095	54.91
816.9	104.8	11.1	17.03	54.91
1221.2	433.2	7.4	15.5	54.91
530	473.9	11.4	15.04	54.91
2652	507.1	15.5	14.4	54.91
3710	531.4	7.4	14.19	54.91
4130	561	7.5	14.24	54.91
4542	599.4	8.5	13.75	54.91

Source: Central Bank of Liberia

Table 4.3.1 provided above shows that in 2003 Liberia recorded GDP of 372.0 million. By the end of 2004, the figure increased to an amount of US\$ 381.5 million, thus leading to 2.6% upward turn in GDP. As of 2005, the economy experienced gradual upward increased in GDP level with US\$ 599.4 million being recorded in 2011. From 2002 to 2011, the average GDP at current price was US\$ 480.20 million above GDP amounts recorded in 2002, 2003 to 2007 respectively. The average GDP growth rate for the nine year period stood as 2.23% which is fall below the 6.2% average GDP growth figure project for the African region.

Table 4.3.1 presents the amounts attracted in foreign direct investment from the period between 2003 to 2011 respectively. In 2003, Liberia attracted net FDI of US\$ 1,587.0 million. The figures further decreased by 30.95 % in 2004. However, a sharp attraction of FDI was shown in 2006 in the tone of US\$1,221.2 million comparing with the attractions of US\$ 1095.9 and 816.9 both in 2004 and 2005 correspondingly. The economy experiences a gradual increase of FDI inflows from 2008 to 2011 which can be attributed to investors' confidence in the Liberia economy. The economy observed maximum net FDI inflows of US\$ 4,542.00 million in 2011 and minimum net FDI inflows in 2007 amounting to US\$ 530.00 million, the overall FDI average of net inflows for the entire period amounted to USD 2,177.29 million.

Table 4.3.2, provides the correlation between the dependent and independence variables for the study.

Correlations

		GDP	FDI	INTEREST	INFLATION	Exchange
GDP	Pearson Correlation	1	.385	.818**	1.000**	.890**
	Sig. (2-tailed)		.306	.007	.000	.001
	N	9	9	9	9	9
FDI	Pearson Correlation	.385	1	.268	.385	.403
	Sig. (2-tailed)	.306		.485	.306	.282
	N	9	9	9	9	9
INTEREST	Pearson Correlation	.818**	.268	1	.818**	.628
	Sig. (2-tailed)	.007	.485		.007	.070
	N	9	9	9	9	9
INFLATION	Pearson Correlation	1.000**	.385	.818**	1	.890**
	Sig. (2-tailed)	.000	.306	.007		.001
	N	9	9	9	9	9
Exchange	Pearson Correlation	.890**	.403	.628	.890**	1
	Sig. (2-tailed)	.001	.282	.070	.001	
	N	9	9	9	9	9

** . Correlation is significant at the 0.01 level (2-tailed).

The correlation between two variables reflects the degree to which the variables are related. The most common measure of correlation is the Pearson Product Moment Correlation (called Pearson's correlation). Pearson's correlation reflects the degree of linear relationship between two variables. It ranges from +1 to -1. A correlation of +1 means that there is a perfect positive linear relationship between two variables whereas the correlation of -1 reflects a perfect negative correspondingly. The statistical correlation of 0.385 shows a positive and weak relationship between foreign direct investment and economic growth in Liberia.

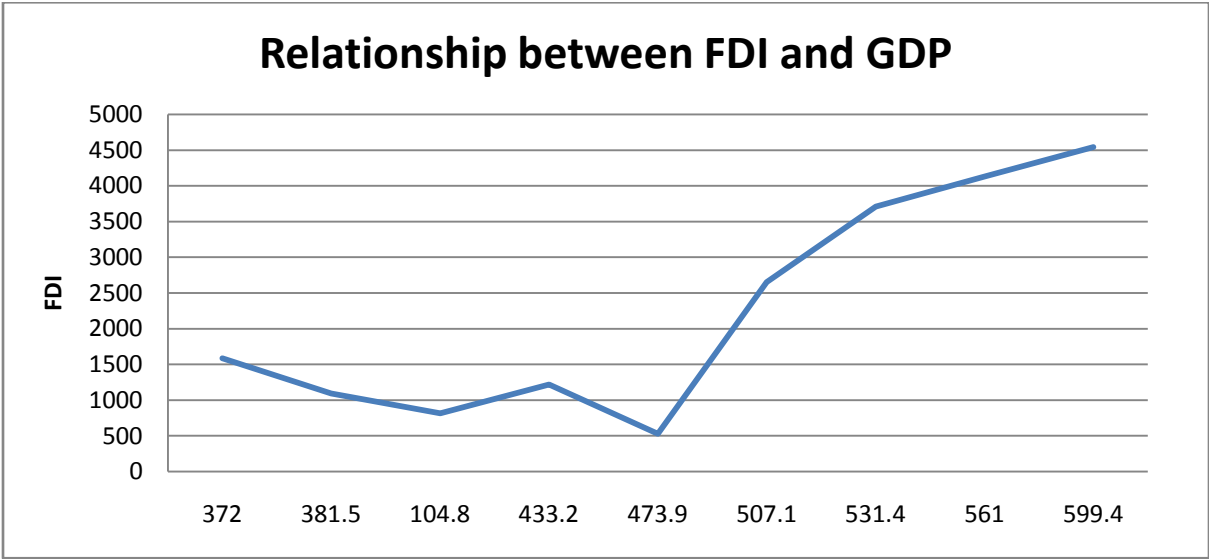
To test the hypothesis, two tail test was conducted at 0.05 test level at ± 1.96 with N-2 degree of freedom (9-2=7). The result is presented in table 4.3.4 below:

Table 4.3.3 Independence sample test statistics

Sample test						
	Test Value = 1					
					95% Confidence Interval of the Difference	
	T	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
GDP	4.382	8	.002	4.000	1.89	6.11
FDI	5.759	8	.000	4.778	2.86	6.69
INTEREST	3.705	8	.006	3.444	1.30	5.59
INFLATION	4.382	8	.002	4.000	1.89	6.11
Exchange	3.411	8	.009	3.556	1.15	5.96

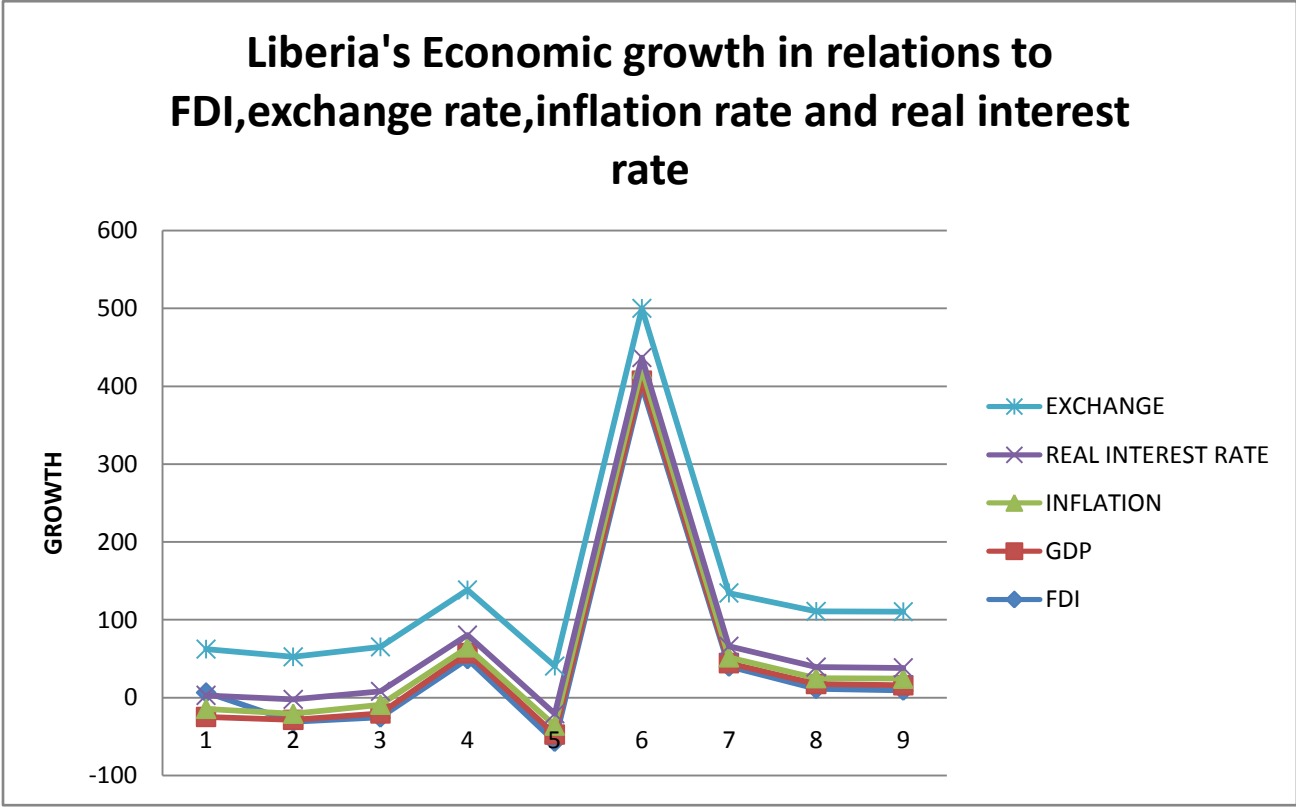
The two tail test was conducted at 0.05 test level at ± 1.96 was compared to the t- value calculated in table 4.3.4 above. The result of the t-value of 4.382 is greater than 1.96 which showed that there is a relationship between FDI and economic growth in Liberia.

Graph 4.4.1, shows the graphical relationship between FDI and GDP



The diagram above gives a picture of the relationship between economic growth in Liberia and foreign direct investment. Tracing the movement of the two variables in the line graph show an inconsistent flow of the variables presented above. This proved the weak relationship as provided by the pearsons correlation. The graph shows a straight line movement in GDP except for the beginning year. This movement depicts a predictable GDP trend for the eight year period. The line graph presents an upward and downward trend in FDI for the entire period. The nonparallel movement between the two variables justified the weak relationship observed from the study.

Graph 4.4.2 shows the graphical relationship between GDP, FDI, inflation rate, exchange rate and real interest rate



The line graph above presents the relationship between economic growths in Liberia with that of FDI, exchange rate, inflation rate, and real interest. The graph presents an upward and downward movement among the variables. However, the direction of the movement among the variables flow within like similar location which depicts the positive relationship among the variables considered for the study.

4.4 Summary Interpretation of Findings

The empirical result of the study showed that there is a cause and effect relationship between FDI and economic growth within the Liberian economy. The statistical correlation of 0.383 revealed a positive weak relationship between economic growth and FDI. This implies that, for every one percent change in FDI will lead to GDP growth increasing by 0.385 percent. The finding of this study tends to support the school of thought that FDI drives economic growth. (Guladia Nyamalon et-al, 2008) attested to the fact that FDI positively contribute to economic growth. Their study on the relationship of FDI on economic growth yielded like result that FDI support economic growth thus confirming the importance of FDI in host country. Borensztein et-al (1998) shows that FDI brings technology which translates into higher growth when the host nation has a minimum threshold of human capital availability.

The study also showed that real interest rate plays significant role within the Liberian economy. Table 4.2.3, above showed a statistical positive and strong relationship between the dependent variable-GDP and real interest rate. The result from the pearson correlation showed that one percent increase in real interest rate will result to 0.818 percent change in GDP growth. The Sig.2-tailed level of 0.007 shows that there is significance relationship between GDP and real interest rate with a T-statistics of 3.705 value at 5% of confidence level. This further explains that real interest rate goes a long way influencing the changes FDI has on the level of economic growth rate. A country with unstable interest rate regime stands a risk of not attracting foreign direct investment and encourages high price level. The inference here is that, an improved rate of interest would lead to market boom and surplus investment thereby increasing economic growth. (Fisher 1930) suggested that expected interest rates change in proportion to the changing expected inflation, or expected real interest rates are invariant to the expected inflation. This suggests that the positive contribution of FDI on economic growth was largely influenced by controlling the behavior of interest rate. The so called relationship between real interest rate and economic growth was attested by (T.M Obamuyi 2009). In his study, which was concentrated on the economy of Nigeria, confirmed that real interest rates have significant effect on economic growth.

The study showed that both inflation rate and GDP flow within similar direction. The result of the pearson's correlation used in this study proved that one percent change in inflation will lead to 100 percent change in GDP growth. There is a significant and strong relationship between the level of inflation and economic growth rate because the Sig. 2-tailed is 0.000. This depicts that as one variable goes up or down so with the other behave in like manner. The finding of this research showed a different view from that of Vikesh Gokal (3004), which proved a weak negative correlation between inflation and economic growth. However, the conflicting result between the two variables in different studies will depend upon whether the research is focused on an industrialized economy or a developing economy that

has different level of inflation threshold In practical reality, low inflation rate and an upward economic growth is never possible. Nevertheless, low inflation rate means slow economic growth. Whenever, money is in excess, there is bidding by the consumers due to which the cost of goods escalates. Notwithstanding, the general agreement among policymakers are that inflation exceeding a given threshold is detrimental to economic growth.

The study also shows a strong relationship between economic growth and exchange rate level. The result of the study provides that a one percent change in exchange rate will lead to 0.890 percentage change in GDP growth. Parallel directional flows between the two variables show a positive relationship which implies that, the increase in one variable will lead to an increase in another variable. Dani Rodrik (2008), studies on the relationship of real exchange rate and economic growth attested to the positive direct relationship between exchange rate and economic growth. His study suggested that an increase in the relative price of tradable and the associated expansion of tradable economic activities have a causal impact on economic growth.

The investment variable as in FDI shows a positive relationship with the following independence variables. Table 4.3.3 above depicts a weak relationship between real interest rate, exchange rate, inflation rate with that of foreign direct investment. The rationale for increased efforts to attract more FDI stems from the belief that FDI has several positive effects which include productivity gains, technology transfers, the introduction of new processes, managerial skills, and know-how in the domestic market, employee training, international production networks, and access to markets (Caves, 1996). If foreign firms introduce new products or processes to the domestic market, domestic firms may benefit from accelerated diffusion of new technology. In other situations, technology diffusion might occur from labor turnover as domestic employees move from foreign firms. These benefits, in addition to the direct capital financing it generates, suggest that FDI can play an important role in modernizing the national economy and promoting growth(Grossman and Helpman et-al 1991,1997)

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

The objective of this project was to ascertain the impact foreign direct investment has on economic growth in Liberia. In addressing this relationship, a research question was postulated as to whether foreign direct investment impact economic growth in Liberia? The result of the Pearson's correlation presented in table 4.3.3 above showed a positive and weak relationship between foreign direct investment and economic growth in Liberia. The Pearson moment correlation shows that movement in FDI level in Liberia influences the changes in GDP level by small margin. The positive relationship which exists between the dependent and independence variables for the study implies a direct and related link between the two variables.

The study considered major macroeconomic indicators as control variables in order to gather conclusive analysis about the interplay between and among variables that influence economic growth. The results from these control variables explain how the status of the economy is radically influence by interest rate, exchange rate and inflation rate correspondingly. The results from the Pearson Moment correlation demonstrate a statistical positive and strong relationship between interest rate, exchange rate and inflation rate with GDP. This shows that at every point in time, a high volatility in these variables will reduce investor confidence in the economy, hence the contraction in economic growth. A sound exchange rate regime, better inflation rate and improve real interest rate relationship with GDP calls for financial deepening so as to maintain the positive relationship in the long run.

Foreign direct investment is seen as one of the variables that foster economic growth in Africa of which Liberia is no exception. Liberia as a developing nation has a prospect for economic growth where FDI is concerned. In my view, this is realized only with adequate employment of realistic foreign direct investment strategy and proper supervision of FDI inflows into Liberia. This will go a long way to stimulate economic growth and development in Liberia.

5.2 Conclusion

There are different schools of thought on the relationship leading to the impact of FDI on economic growth in host country. The fact remains that FDIs will benefit host nation citizenry if the policymakers are developmentally oriented and possessed a deep sense of national patriotism. Other scholars suggested that individual studies be done to examine the link between FDI and economic growth since it is country specific. The study of FDI impact on growth in Liberia is statistically positive and weak. FDI investment in the Liberian economy should be closely monitored and adequately supervised. A weak relationship depicts that not much is being achieved from FDI operation in Liberia. The impact of the huge FDI inflows to Liberia is fairly inconsequential.

FDI is thought of as one factor which contributes to economic growth and this case has been proven for Liberia. The statistical weak relationship between FDI and economic growth in Liberia would be attributed to poor development in human capital, corruption and lack of proper FDI supervision etc which tend to weaken the development agenda and reap the requisite overflow accomplish by FDI in host country. The study considered other control indicators that influence growth impact in a given country economy. The relationship between these control variables and GDP proved to be statistically strong which implies proper management of fiscal and monetary policies.

The study of FDI and its contribution on host nation economy is captivating and important for understanding economic globalization among different economies across the world. Most of FDI being attracted to Liberia are focused in the extractive industry such as iron ore, gold, diamond etc. Majority of Liberian survive from subsistence agriculture production and lack the requisite skills to exploit the maximum benefits that FDI produces in host country. Liberia can attract more from foreign direct investment operations once there are appropriate and rigorous control mechanisms and realistic policy instituted by those charge with governance to supervise FDI being attracted.

5.3 Policy Recommendations

Given the forward looking investment environment in Liberia, it is recommended that policymakers stress the importance of improved human capital development. From my point of view, countries with low level of human capital will have low level of FDI effect relative to countries with high level of human capacity, although it might be inconsequential in some instances. The reasoning behind the improvement of high level of human capital is that, countries with improved human capital will be in better position to utilize the hi-tech spillover of FDI. Policymakers should allocate 20 percent of the national budget for improvement in the human capacity development in Liberia.

Most multinational investors are attracted to countries that foster the protection of property and investment. In my view, lack of adequate contract and property rights enforcement can limit the interaction between foreign and local firms who will invest in an economy. Following such development, it is recommended that the Liberian legal system be strengthened to protect investors so as create room for economic growth. Other branches of Government interference with the judiciary operations undermine the fair ruling and at such, individual investors, institutional investors and other multinational investors would prefer countries with high judiciary credibility for investment.

Financial deepening is an impetus of economic growth which also provide for attraction of FDI benefits. Markets that are developed stand to benefit enormously from FDI operations in diversities of ways, hence it is recommended that those charged with governance ensure that the financial market is strengthened by the introduction of new financial instruments and capital market establishment so as to reap the benefit emanating from FDI.

Most of Liberia FDIs are focused in the extractive industry. Liberia produces what she does not consume and consumes what she does produce. Policymakers in Liberia should encourage diversification in FDI and divert a sizable portion to the agriculture sector where most Liberians will benefit directly. Finally,

since most FDIs are focused in the extractive industry, policy makers should institute measures where 10 percent of extracted resources should be processed into finished products in Liberia.

5.4 Limitations of the study

The interest of this study was to access the impact of foreign direct investment on economic growth of the Liberian economy. It is clear that study of this sort should engross a survey of sizable number of economies if not all economies as the research population. However, time and material resources did not make this feasible and for this reason the study is concentrated on the Liberian economy, gazing from 2003 to 2011 fiscal year. Furthermore, due to the 14 years of political upheaval it was also impossible to collect sufficient data for sizable number of years as there was huge data gap to run adequate time series study.

This study used quantitative method, thus secondary data from the bank of Liberia and World Bank to analyze the impact of foreign direct investment and Liberia's economic growth. The study gathered data relying on information from the above mentioned institutions. As a matter of fact, some institutions manipulate data to achieve set objectives. Therefore, data collected might probably miss a fair view. Considering all these circumstances, this may therefore not give room for fair generalization of the findings. However, the validity of the findings emanating from the research cannot be compromised in spite of these limits.

5.5 Suggestions for Further Research

Foreign direct investment plays an all important role within achieving growth and development in countries around the world especially for developing nations in which Liberia is not an exception. Therefore, it is important for intensive research to be carried out on FDI measuring different levels of development indicator and employing appropriate ways of deriving the utmost yield from foreign undertaking in host nation.

The focus of this study was to establish the relationship between FDI and economic growth where we considered some macroeconomic indicators such as real interest rate, inflation rate and exchange rate as control variables. Further studies on this matter should consider variables such as population, employment rate, poverty reduction and many other variables so as to ascertain the level of influence FDI imposes on other macroeconomic variables so that adequate policy recommendations be made to tackle negative influences.

FDI is the vehicle to generate growth thus a most important ingredient for poverty reduction. The impact of FDI can remain stagnant in the face of systematic corruption. Therefore, further studies should be conducted to investigate the impact of corruption on FDI benefits in Liberia.

REFERENCE

- AFRODAD (2008). Critical Assessment of AID Management and Donor Harmonization in Liberia
- Agarwal J. P. (1980) Determinants of FDI investment: A survey, *Welwirtschaftlic Archir*, 116,739-73
- Anna Ek, (2007). The Impact of Foreign Direct Investment on economic growth: The case of China
- Baracaldo, D. G, Paola V. H (2005).“Crecimiento Económico y Flujos de Inversión Extranjera Directa”. Departamento de Economía de la Universidad de Antioquia y Universidad Externado de Colombia.
- Blonigen, B.A (2006). Foreign Direct Investment Behaviors of Multinational Corporations
- Borensztein, E. J, De Gregorio, and J.W. Lee (1998). “How Does Foreign Direct Investment Affect
- Borensztein, E., De Gregorio, J. and Lee, J.W. (1998), How does foreign direct investment affect economic growth?, *Journal of International Economics*, 45, 115-135.
- Buckley, P.J. and Casson, M.C. (1976). “The Future of the Multinational Enterprise”, Homes Meier:London.
- Carkovic, M, Levine, R (2003). Does FDI Accelerate Economic Growth? University of Minnesota, Working Paper
- Carkovic, M. and R. Levine,(2005). Does Foreign Direct Investment Accelerate Economic Growth?, in “Does Foreign Direct Investment Promote Development”, Edited by Moran,
- Castilla, Luis Miguel (2005). “Reporte de Economía y Desarrollo 2004-05”.
- Caves, R. (1974). Multinational Firms, Competition and Productivity in the Host Country, *Economica* 41: 176-193.Corporación Andina de Fomento (CAF).Countries, Work Development, 21-41
- Dunning, J.H, (1993). Multinational Enterprise and Global Economy Workinhham, Addison-Wesley.

Dymer W. G, Wilkins, A. L (1991). Better Stories, not better construct, to generate better theory, *Academy of Management Review*, Vol. 16, No: 3, 613-619
Economic Growth? in *Journal of International Economics* 45, p.115–135.

Economy Watch (2010). Foreign Direct investment and infrastructure Development

Esso, L.K (2010). *International Journal of Economic and Finance: Long run relationship and causality between foreign direct investment and economic growth.*

Graham, E. M., and M. Blomstrom, Institute for International Economics, Washington DC,

Grossman G., Elhanan H. (1994). Endogenous Innovation in the Theory of Growth, in: *Journal of Economic Perspectives*, Vol.8, No.1 (1994), pp. 23-44.

Hansen, H. and J. Rand (2006). *Causal Links Between FDI and Growth in Developing.*

Hymer (1960). *Foreign Direct Investment in developing countries*

Hymer (1976). *The international operations of national firm: The survey of direct foreign investment. PHD. Dissertation, MIT (publication for MIT press)*

Hymer, S., (1976). *The International Operations of Nation Firms: A Study of Foreign Direct Investment*”, Cambridge, MLT Press.

Iverson C. (1953). *Aspect of the theory of international capital movements* London oxford University press

Kim and Hwang, (2000). *The Role of Foreign Direct Investment in Korea’s Economic Development productivity Effects and Implications for currency crisis*

Kimotho A. M (2010). *The relationship between FDI and economic growth: A study of the Kenyan economy*

- Lanier, F. et-al (2011). Center for International Conflict Resolution: Columbia University – school of International and Public Affairs.
- Lemi, Likosang Wani (2005). Trend analysis of overseas development assistance and foreign direct investment, and their impact on economic growth: The case study of Kenya thesis (M.A) – University of Nairobi.
- Madura, Jeff (2008). International corporate finance
- Marco, Neuhaus (2006). The impact of FDI on economic growth, An analysis of transition countries in Central and Eastern Europe.
- Marinelli, Lawrence A. (1964). Liberia’s Open Door Policy, the journal of modern Africa studies vol. 2 No. 1. March 1964.
- Meadows D.L, Randel J (1973). The Limited to Growth Washington DC, Potomac Associates
- Mutasa Charles (2008). African forum for Network on debt and development: A critical assessment of AID management and Donor Harmonization in Liberia
- Nicholas Kaldor (1957) The Economic Journal, Vol. 67 No. 268(Dec 1957)
- Pesaran, M. H, Shin, Y, Smith, R. J. (2001). Bounds Testing Approaches to the Analysis of Level Relationships, Journal of Applied Econometrics, 16, 289-326.
- Pestova, A. et-al (2010). Institute of Economic Forecasting of the Russian Academy of Sciences: Promotion of foreign direct investment in Russian to improve the quality of economic growth
- Ramírez, C. E, Flórez, L(2006). “Apuntes de Inversión Extranjera Directa: Definiciones, Tipología y Casos de Aplicación Colombianos”. En: Apuntes de Economía, Universidad ICESI, Colombia, No. 8 (ISSN 1794 – 029X).
- Ricardo D. (1821). On Protection to Agriculture, in: McCulloch J. R. (1846), The Works of David Ricardo, Edition 2, London: John Murray, pp. 455-458.
- Sanderatene, N. (2011). The Sunday Times Economic Analysis
- Soumare, I (2009). African Economic Conference, impact of FDI of poverty reduction in Africa.

Smith A. (1864). *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Book I-V, London:
T. Nelson

Toda, H. Y, Yamamoto, T. (1995). Statistical inference in Vector Autoregressions with
possibly integrated Processes, *Journal of Econometrics*, 66, 225-250.

Toward Earth Summit (2002). *Foreign direct investment: A lead driver for sustainable
development*

UNCTAD (1997). *Foreign Direct Investment in ACP Countries"*. New York and Geneva. UN

UNCTAD (1997). *World Investment Report, FDI and Competition Policy*

WTO (1996). *Annual Report 1996, Vol. 1, Trade and Foreign Direct Investment*

Jayasuriya, S., and D. Weerakoon(2001). *FDI and Economic Integration in the SAARC Region*. In
T.N. Srinivasan (ed.) *Trade, Finance and Investment in South Asia*. New Delhi: Social Sciences
Press

**APPENDIX I: EVERY YEAR FDI, GDP, INFLATION INTEREST RATE
AND EXCHANGE RATE**

FDI	GDP	INFLATION RATE	INTEREST RATE	EXCHANGE RATE
1587	372	10.4	17.06	59.38
1095.9	381.5	7.8	18.095	54.91
816.9	104.8	11.1	17.03	57.03
1221.2	433.2	7.4	15.5	58.01
530	473.9	11.4	15.04	61.27
2652	507.1	15.5	14.4	63.21
3710	531.4	7.4	14.19	68.29
4130	561	7.5	14.24	71.4
4542	599.4	8.5	13.75	72.23

Source: Central bank o Liberia and World Bank