
The relationship between capital market development and foreign direct investment inflow: VEC impulse evidence from African countries

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Abstract

Socio-political and economic problems have contributed to civil unrest in many African countries. In some cases, this problem has also caused distrust in the political leadership. To grow African economies and alleviate poverty, the attractiveness of the continent to foreign direct investment (FDI) is critical. Among others, the development of African capital markets has been identified as a pull factor for FDI inflows. Using data generated from the World Bank, Economic Freedom House and a few other sources between 1980 and 2012 in various recent econometric estimations, it is observed that capital market development plays a significant role in African countries with less developed capital markets as a pull factor for inflow of FDI. The study further suggests that FDI responds more spontaneously to the development of banking sector more than the other capital market variables used in our estimation. The impacts of nonfinancial private sector credit on inflow of FDI are more significant at the long run as compared to credit provided by private sector, which is only significant in the short run. It is thus suggested that efforts be directed towards developing the existing capital markets in Africa while initiating new ones as a way of realising sustainable economic growth on the continent, towards alleviating poverty and to achieve social peace.
