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The Linkage between Foreign Direct Investment and Intra-Regional Trade within ECOWAS

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Executive Statement Non of the others have colour?

The objective of this policy brief is to inform the Ministers of Trade and Investment of provide in full (ECOWAS) countries aboutthe importance of the linkage between Foreign Direct Investment (FDI) and trade for developing countries. FDI is considered an important means of promoting export of the host countries. This is true of inward FDI, which comes for efficiency reasons. Conversely, there is concern that large flows of outward FDI results in a decline in the host country's exports and loss of jobs.This in turn assumes that the exports of the source country will fall as FDI substitutes for trade.

Against this background, the research focused on the trade and investment relationship for selected ECOWAS countries. Emphasis was placed on the increase in cross border Nigerian banks in other ECOWAS countries. Relevant regional policies were also examined. Findings indicate that the increase in banking sector investments resulted in increased trade.This impacted trade more effectively than the regional policies. The analysis further shows there is positive correlation between intra-regional trade and FDI, suggesting they are complementary. The study proposes the inclusion of investment provisions in trade agreements dealing with capital flows within ECOWAS. In addition, policies that enhance investment in banking should be emphasized.

Introduction

The research is motivated by the importance of the linkage between Foreign Direct Investment (FDI) and trade for developing countries. FDI can have significant benefits for host countries such as, upgrading the technical and managerial skills and raising competitive strengthin the international market. This is particularly true of inward FDI, which comes mainly not for the domestic market. Conversely, as earlier mentioned, there is concern that large flows of outward FDI results in a decline in the host country's exports and loss of jobs, indicating transfer of productive capacity from the source country to the host country. It in turn assumes that the exports of the source country will fall as FDI substitutes for trade.

The importance of this linkage explains the increased inclusion of investment provisions in many trade agreements dealing with flows of capital globally. This has resulted in harmonization of trade and investment policies in regional agreements. However, this harmonization is yet to be realized in provide in full (ECOWAS) trade agreements. In addition, there are ongoing debates regarding the nature of relationship between trade and investment. Economic theory suggests that international trade and investment are complements rather than substitutes if trade between the two countries is based on comparative advantage. However, if the trade is based on absolute advantage then there may be substitution between trade and investment.Other arguments indicate no causality between exports and FDI in India. The linkage between trade and investment therefore remains an empirical issue.

There has been limited attempt to investigate the linkage between FDI and international trade within ECOWAS. Existing studies on the subjecthave focused mainly on the determinants and potentials of intra-regional trade and FDI within Africa.
Accordingly, this study examines how trade and FDI are related using data from selected ECOWAS countries. The main focus is first, to carry out an analysis of the pattern and trend of intra-regional trade (import and export) and FDI in ECOWAS; and second, todetermine the linkage between trade and FDI within ECOWAS. This is particularly important for policy owing to the increased efforts at regional integration within ECOWAS.

Methodology

Data employed in the research are; intra-regional import and export for selected ECOWAS countries for the period 1980 to 2010, sourced from the provide in full (IMF) Direction of Trade Statistics (DOTS); and FDI for the same period in the same set of countries, were derived from provide in full (UNCTAD) database. The UNCTAD database did not provide information on the destination of FDI leaving ECOWAS. However, based on the Linder Hypothesis, FDI is more likely to occur between countries with similar economic credentials, with proximity as a key criterion. Consequently, total outward-bound FDI in the region is taken as a proxy for intra-ECOWAS FDI.

Map of Africa Showing ECOWAS countries

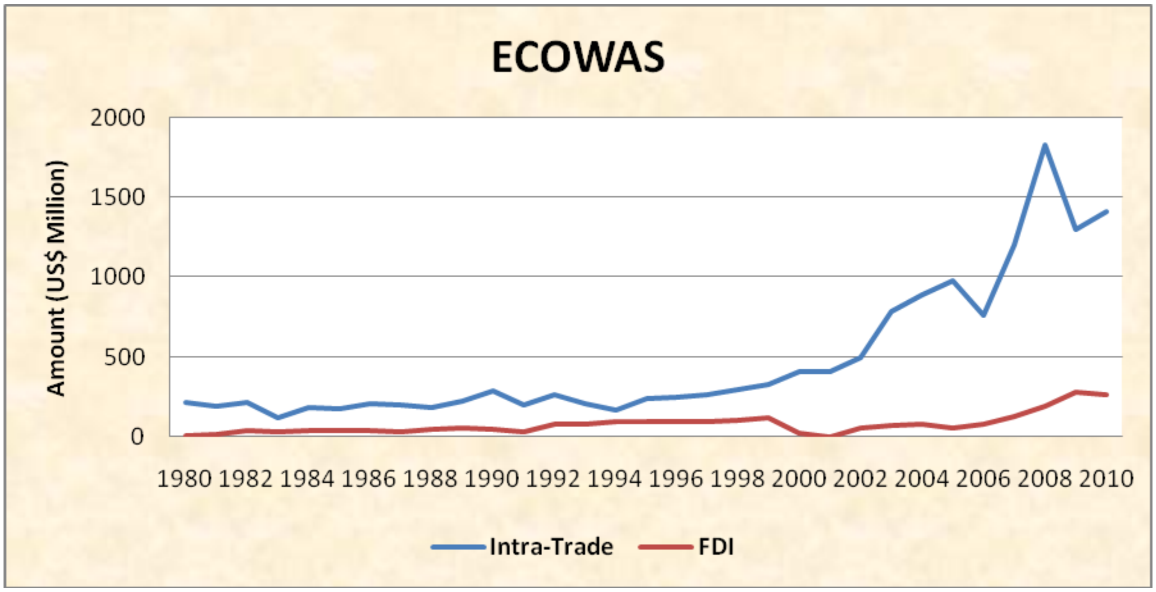
The estimation began by determining the descriptive statistics of the variables. This required estimating the mean, median, maximum and minimum values; skewness, kurtosis, and standard deviation of the series. Most of the series had values greater than 0.05, indicating that the series are normally distributed. The value of skewness for each of the series is close to zero, while the kurtosis ranges between 2.7 and 3.1. Largely, the series can thus be adjudged to be normally distributed.

The strength and direction of the linear association between intra-ECOWAS trade and FDI in ECOWAS countries was verified based on a correlation analysis. A positive linear association indicates complementarity between the trade and investment, while a negative linear association suggests they are substitutes. Descriptive analysis using charts and graphs was also employed in examining the trend of the data.

Key Findings

The research has four key findings. First, the analysis indicates there is positive correlation between intra-regional trade and FDI. This suggests that they are complements. The trend analysis also supports the complementarity of intra-regional trade and FDI in selected ECOWAS Countries. An illustration is provided in Figure 1 below.

Figure 1: Comparing Intra-Trade and FDI for Selected ECOWAS Countries (Benin, Liberia, Nigeria and Senegal)



Specifically, the resultshow a positive linear association between the two variables in Benin, Liberia, Nigeria and Senegal. While Mali and Niger revealed a negative linear relationship. Largely, this implies that FDI and intra-ECOWAS trade are complementary in Benin, Liberia, Nigeria and Senegal, and substitutes in Mali and Niger. On the degree of association, intra-ECOWAS trade and FDI are moderately associated in Benin, Mali, Nigeria and Senegal. They are strongly associated in Liberia but weakly associated in Niger.

Notwithstanding the substitution effects in the case of Mali and Niger, there is sufficient evidence to infer a complementary relationship between intra-regional trade and FDI in ECOWAS. The ECOWAS countries that suggested positive linear relationships between intra-trade and FDI (Nigeria, Liberia, Senegal, and Benin) accounted for 81.4% of the total volume of trade in the six selected countries between 1980 and 2010. They also accounted for 97% of the total outward FDI in ECOWAS in the same period.

Second, the increase in Nigerian bank branches in other ECOWAS countries had significant impact on trade within the region. For instance trade between Nigeria and Ghana increased from $50m in 2006 to $150m in 2010. This period coincided with increased Nigerian bank branches in Ghana. Similar trends are reported for other ECOWAS countries with Nigerian Bank branches. The increase in cross-border bank branches was more effective on trade than the regional trade and investment policies.

Third, the research showed that non-tariff barriers influenced trade negatively within the region and accounted for the ineffectiveness of some of the policies. The prominent ones include levies on some commodities and existence of road blocks along trade routes.

Finally, the analysis suggested that the trade and investment policies were not complementary. For instance little emphasis was placed on investment provisions relating to capital flows in the trade agreements. These findings have implications for trade and investment within the region and are captured in the ensuing section.

Policy Implications

The arguments drawn from the research have to be seen in the context of regional trade policies within ECOWAS and deepening intra-regional trade. Based on the findings, the following key issues emerge;

First, the complementary relationship between trade and investment identified suggests there are significant spill over effects from FDI to trade. If the existing lack of harmony between investment and trade policies is not corrected, ECOWAS countries will not enjoy significant benefits of the complementarity between trade and investment. This points to the crucial role for policy harmonization in order for ECOWAS countries to benefit from trade and investment. Second, the existing non-tariff barriers to trade observed in the research have impacted negatively on trade within the region. Specifically, these barriers have resulted in increased transport costs and undue delays. As a result, there is need for policies that tackle non-tariff barriers to trade and investment within ECOWAS.

Recommendations

The research proposes the following recommendations;
First, for FDI to contribute fully to promoting exports of ECOWAS member countries, host-country ministers of trade and investment should focus on including investment provisions in trade agreements dealing with capital flows within the region.

An encouraging sign is the persistent efforts towards harmonized liberalization of trade and investment regimes in West Africa which is a vital step towards creating a suitable environment for investment inflows. Hence, the ongoing process of regional trade agreements should focus on trade liberalization, by reducing particularly non-tariff barriers. It should likewise consider investment liberalization.

Second, there is need for policies that promote investment in banking in order to enhance trade within the region.To maximize the potential of this process, more ECOWAS countries need to reform and strengthen their banking-related regulatory, supervisory and legal framework.
On the whole, the study proposes that economic reforms should be strengthened at the national and regional level to maximise the benefits from regional integration whilst minimising associated tariff and non-tariff barriers to trade and investment. The study therefore advocates the development of measures to facilitate trade and the pursuit of harmonised investment policy objectives.

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