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## Article

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## DEVELOPMENT ECONOMICS | RESEARCH ARTICLE

# Impact of business regulations on foreign direct investment inflows and economic growth in East African countries

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**Abstract:** Continuous improvement of the business environment is important for countries seeking to benefit from increased trade and investment through regional integration. Creating an enabling environment for businesses to thrive and expand has become a new concept in international development organizations, and a good business climate allows good ideas to take root, which leads to the creation of jobs



Getaye Gizaw

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### PUBLIC INTEREST STATEMENT

This study aims to highlight the relationship between business regulations, foreign direct investment inflow, and economic growth in East African countries. It also examines the impact of the ease of doing business indicators by examining the successes and failures of the key components of the indicator, together with projects of local economic development. There is still little literature available on the ease of doing business in the region, and it is the aim of the researcher to communicate what is happening in other developing regions that have implemented a similar approach to development through the Ease of Doing Business Policy, highlighting the success factors and failures of the key aspects of the policy. Thus, developing regions can adopt a similar method to promote development.

and better lives for host countries. The main objective of this study was to investigate the impact of business regulations on FDI inflow and economic growth in East Africa region using data collected from the World Bank spanning from 2010–2019. The study finds that dealing with construction, enforcing contracts, getting credit, getting electricity, paying tax and protecting minority investors have a significant impact on FDI inflow in the region. While enforcing contracts, getting credit, protecting minority investors, resolving insolvency, starting a business and trade across borders have a significant impact on economic growth in the region. Moreover, each additional reform during 2010–2019 is associated, on average, with a 3.09% increase in FDI inflows and 2.24% increase in GDP in East African countries. The findings of this study will help policy makers in the region to establish a strong legal framework of business regulations to attract FDI inflow into their economies, to adjust their ease of doing business procedures to attract FDI to their economies and to promote regional economic growth. This will also assist investors in monitoring these key indicators to facilitate investment decisions in foreign countries.

**Subjects:** Economics; Political Economy; Environmental Economics; History of Economic Thought; Finance; Business, Management and Accounting; Industry & Industrial Studies

**Keywords:** Business regulation; economic growth; effect; foreign direct investment

## 1. Introduction

Explaining economic growth has long been a focus of macroeconomic research. Savings, investment, geography, culture, population, macroeconomic fundamentals, politics, trade, or a combination of one or more of these are among the factors that are widely thought to explain economic growth. Governments that care about their country's economic health and opportunities for its citizens pay attention to more than just macroeconomic problems. They also pay attention to the laws, regulations, and institutional arrangements that shape economic activities.

A good business environment enables good ideas to take root, leads to jobs creation and leads to better lives. As studied by (MogesEbero & Begum, 2016), when the business environment becomes more complex, turbulent, and dynamic, the impact on business operations and performance will be greater. Therefore, it could be a requirement for all organizations to direct their attention to the business environment when formulating their business models and strategic management policies to determine their survival, growth and profit motives. Furthermore, it is suggested that the easier it is to start and run a firm, the more investors are enticed to do so, resulting in more jobs being created. This, in turn, is capable of creating viable private sector development and growth of FDI inflow and GDP in developing countries (Schulpen & Gibbon, 2002).

Since 2006, the World Bank has ranked almost 200 countries in terms of their business environment and “ease of doing business” in these economies. The rationale behind this is the importance of a thriving private sector to promote high and inclusive growth and development. The World Bank's Doing Business reports, which provide quantitative data on rules influencing many aspects of a business's life, have become an important instrument and yardstick for gauging business climate improvement (Adepoju, 2017; Joshua et al., 2021). The ease of doing business is a composite figure that contains several variables that define how easy it is to do business in a given country. It is calculated by combining the distance from the frontier scores of the different economies. The distance-to-frontier score is calculated using regulatory best practices for doing business as the parameter, and economies are compared to that parameter. It provides quantitative indications on regulations for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency.

The ease of doing business motivates domestic producers, as well as foreign investors. Taking in to account the advantages of domestic businesses, foreign businesses will bring jobs and new technologies into a country (Hassan & Basit, 2018). Currently, the improvement in the ease of doing business indicators in developing countries has good explanatory power in determining higher FDI flows and economic growth in these countries. Moreover, according to the World Economic Report Forum 2014–2015 problematic areas of doing business include corruption, government bureaucracy and poor infrastructure among other areas (Bonga & Mahuni, 2018).

African countries have been trailing behind industrialized and growing economies for many years. Nevertheless, they have made significant improvements in recent years as they have made doing business easier. For countries seeking to benefit from increased trade and investment through regional integration, the continuous improvement of the business environment is critical. The opportunities of East African countries, which have had rapid growth over the last two decades, have been increasing. The countries with the highest economic growth were Ethiopia, Rwanda, Tanzania, Kenya, and Djibouti. Industry and services have fueled real GDP growth in both Ethiopia and Rwanda. The service sector has also been the main driver of growth in Tanzania and Kenya, followed by the agriculture sector. Additionally, the ongoing program to develop industrial parks, continuing foreign direct investment inflows, and the government's productivity-enhancing investments in agriculture are opportunities for continued economic growth in the region (Outlook, 2019).

The Doing Business 2020 report reveals the willingness of a large number of African countries in general, and East African countries in particular to improve their administrative procedures. This is reflected in various reforms that encourage the creation of small and medium-sized enterprises. A majority of East African economies are yet to make significant reforms to create an easier business environment, as a new World Bank report shows.

According to the latest *World Investment Report* from the UN Conference on Trade and Development (UNCTAD), foreign direct investment (FDI) in East Africa grew by 3.5% to approximately US\$9bn in 2018. Although FDI flows into the region increased, the pace of growth was considerably slower than the annual average of 12.3% in 2016–17. The moderation primarily reflects a slump in flows into Ethiopia (which fell by 17.6%, to US\$3.3bn), Seychelles (by 35.4%, to US\$123 m—the lowest level since 2005), Mauritius (by 16.1%, to US\$371 m) and Madagascar (by 10.3%, to US\$349 m). All other East African countries registered a rise in FDI inflows in 2018, but the key countries that helped to offset declines elsewhere and drive the regional increase were Kenya (where FDI inflows grew by 27.5%, to US\$1.6bn), Uganda (by 66.6%, to US\$1.3bn) and Tanzania (by 17.8%, to US\$1.1bn). Comoros and Djibouti also experienced strong growth in FDI inflows last year; however, this was from a low base and did not contribute significantly to the offsetting impact. Foreign direct investment (FDI) inflows into Eastern Africa dropped by a fifth in 2018 compared to 2019, marking a third straight year of decline exacerbated by the Covid-19 pandemic that restricted international capital flows. The decline in FDI now poses a challenge for East African countries which face pressure to adjust their regulatory environments to attract foreign capital while trying to protect local investments.

Despite the fact that most governments aim to make it simpler for businesses to succeed in order to attract FDI and other commercial prospects, current rankings of the ease of doing business place certain countries at the top of the list, while others walk near the bottom, as is customary. The East African region continues to face various downside risks that could undermine its economic growth and development prospects. The major risks are agricultural vulnerability to the vagaries of nature, heavy reliance on primary commodity exports, and oil prices in oil-importing countries rising. Another major concern is the continuation of current account deficits and the resulting increase in external debts. Finally, state fragility poses a threat to Burundi, Somalia, South Sudan, and, to a lesser extent, Ethiopia in terms of security and economic advancement ((Sujit et al., 2020); (Outlook, 2019).

Numerous studies have evaluated the impact of business regulation on FDI inflow and economic growth across the globe, to the best of our knowledge, no single study has been undertaken in the Eastern Africa region (Anggraini & Inaba, 2020; Haliti et al., 2019; Nangpiire et al., 2018; urban\_benedikt, 2019). However, these empirical studies found that the effect of business regulations on FDI inflows and economic growth differs across regions and over time. Therefore, this study investigates the impact of business regulations on FDI inflows and economic growth in the East African region over the year 2010–2019. Over the last few decades, the region has made significant reforms, and also has countries that are both the best and poor performance in terms of ease of doing business indicators score. In addition, those studies that were undertaken so far used business indicators as a measure of all aspects of the business environment, did not consider other macroeconomic variables, and tried to analyze the impact of ease of doing business on FDI inflows or on economic growth. Other studies have utilized country rankings as a variable for each Doing Business indicator.

Therefore, this study contributes to the literature in different important aspects. First, considers both the ease of doing business individual indicators and total score as proxy variables for business regulation reforms in its analysis. It also considers FDI inflows and GDP growth as the outcome variables. Second, to evaluate the regional impact, we consider the 14 selected East African

economies using the recent period of 2010 to 2019. Third, this study included other macroeconomic variables as control variables to measure all aspects of the business environment.

Generally, this study aims to investigate the effect of business regulation reforms on foreign direct investment inflow and GDP growth in East African countries using panel data analysis.

Specifically, the study aims to describe the status of the indicators of Doing Business in the region, to determine the level of foreign direct investment and economic growth in the region and to verify which of the indicators of the Ease of Doing Business greatly affect foreign direct investment and economic growth in the region. The question worth pursuing in this study is: does ease of doing business indicators influence the amount of FDI inflow and economic growth of those countries? Does the overall indicator of ease of doing business influence the amount of FDI inflow and economic growth of those countries? Therefore, this study establishes the ease of doing business relationship with FDI inflow and economic growth in East African countries.

To the best of our knowledge there is no single and such integrated empirical work; regarding to the nexus between ease of doing business, FDI and economic growth in the region; therefore, this is the first attempt to close this gap. This study will provide a solid document that might be used as a source of information regarding, the impact of ease of doing business indicators on FDI and economic growth, for various actors (readers, students, researchers and policy makers) in the region. It will also help the responsible bodies and stakeholders of an area in which the study is conducted to get information, to improve strategic plans and to reconsider social policy. This can be possible through publishing and providing a finding document to responsible bodies. Thus, our work is related to a long-standing line of research in the empirics of ease of doing business, FDI and economic growth literatures that has seen a recent resurgence of interest in the region.

## 2. Reviews of related literatures

This part of the paper summarized the relevant recent literatures proffered by authors regarding the business regulation reforms, FDI and economic growth. Since the inception of doing business indicators, there is now a vast body of literature of studies trying to explain, this concept. The ease of doing business and its implications for countries' economy have been analyzed from different points of view by various researchers. A number of studies on how economic growth or FDI for a country or region is affected by the ease of doing business in a particular country or region. It reviews some of the literature regarding the ease of doing business, FDI and Economic growth. It also touches on the effect of ease of doing business indicators and other factors on FDI and



economic growth, and the factors affecting FDI and economic growth from the point of view of multinational companies and regions.

The working paper synthesizes and critically evaluates the currently disparate literatures regarding ease of doing business indicators, FDI and economic growth across the globe. It summarizes what is known about these issues at the present time, identifies gaps in the knowledge base, reflects on some of the patterns evident in the literature and highlights opportunities for further research, thus serving as a resource for other researchers investigating this important area of study. Given the context for our review, we concentrated our search on recent literature (2017–2020), English language texts, and a combination of academic studies, policy documents and practitioner reports. Research findings from both developed and developing countries were included as relevant (Tables 1 and 2).

**Table 1. Overviews of Business regulation reforms and FDI**

<b>S.no</b>	<b>Authors/years</b>	<b>Titles and Models/ techniques</b>	<b>Results/findings</b>
1	(Nangpiire et al., 2018)	Ease of doing business and foreign direct investment inflow among Sub-Sahara African countries; Using Correlation and Regression analysis.	The paper found that, the overall ease of doing business indicators have a statistical influence in attracting FDI into Sub-Sahara African countries.
2	(Vogiatzoglou, 2016)	Ease of Doing Business and FDI Inflows in ASEAN; A Panel econometrics analysis.	It found that an entrepreneurship-friendly and efficient business regulatory environment is a particularly important determinant of inward FDI.
4	(Hassan & Basit, 2018)	Ease of Doing Business and Its Impact on Inward FDI across the globe; Regression and Correlation analysis.	The findings of the study suggested the ease of doing business enables inward FDI through better contract enforcements, getting credit and registering property.
6	(Anggraini & Inaba, 2020)	The Impact of the Ease of Doing Business on Foreign Direct Investment across the globe; Fixed effect and two step GMM method.	The study found that the overall EDB score has a positive impact on attracting more inward FDI. Furthermore, this study considers getting credit and getting electricity as the most important indicators that drive inward FDI in the host countries.
8	(Haliti et al., 2019)	The Impact of the Ease Doing Business Indicators on Foreign Direct Investment in the European Transition Economies; A Dynamic panel methodology	Based on the results of the study, the main business-led indicators that have a positive and significant impact in attracting FDI in 16 European transition countries.

Source: Authors compilation

**Table 2. Overviews of Business regulation reforms and economic growth**

S.no	Authors/years	Titles and Models/ techniques	Results/findings
1	(Bonga & Mahuni, 2018)	Assessing the Impact of Ease of Doing Business and Corruption on Economic Growth for Africa Free Trade Zone (AFTZ) Member States; Pooled OLS, Fixed effects, and random effects models.	The study findings shows that corruption, trading across borders, getting credit, registration of property, dealing with construction permits, and starting business have a significant impact on the economic growth.
3	(urban_benedikt, 2019)	The impact of India's ease of doing business program on the manufacturing sector; A Pooled OLS, first difference and fixed effect estimations approaches.	The findings of the study indicated that an improvement in countries EDB score raises in their Manufacturing sector GDP.
4	(Adepoju, 2017)	Ease of Doing Business and Economic growth across the globe; A panel random effects model	The study evidence obtained that the ease of doing business has an overall statistically significant effect on the annual growth rate of GDP per capita. However, the estimated coefficients of the EDB indicators for the subgroups (i.e., full sample, subsample or by income group) were found mixed results.
5	(Estevão et al., 2020)	The Doing Business ranking and the GDP. A qualitative study	The study concluded that credit the significant determining factor for both the ease of doing business and GDP per capita.

Source: Authors compilation

In summary, this part has demonstrated that numerous studies suggest that favorable business environments are helpful for attracting FDI inflow and economic growth of the host countries. The empirical literature reviews shows that business regulations either as a whole or as sub-indicators play a key role in attracting FDI inflow and generating economic growth. However, the effect of business regulations on FDI inflow and economic growth differs across regions and over time. Therefore, this study investigates the impact of business regulations on FDI inflow and economic growth in East Africa region over the year 2010–2019.

### 3. Theoretical framework

Establishing relationships between DBI variables and the volume of FDI inflows (USD million) requires a theoretical foundation based on two issues: first, the factors that MNEs can decide (by the intensives MNCs have) to invest abroad or specifically invest in the host country. Second, there are certain factors that similarly encourage the FDI inflows, particularly DBI variables, which are indicate the level of institutions operation in a country; these indexes measure strengths of legal institutions, complexity, and cost of regulatory process for operating a business in host countries. The first theory is explained by John Dunning's OLI paradigm or the eclectic paradigm, while the second theory is illuminated by various empirical studies based on Douglass C. North. The eclectic or OLI paradigm (Dunning, 2000) emerges affirms reasons for becoming MNCs.



According to (Dunning, 2000) “Eclectic or OLI paradigm theory” that FDI decision abroad depends upon OLI determinants. The term OLI denotes ownership, location and internationalization environments. First, the term (O) indicates the ownership factors of the issues for MNCs to decide FDI abroad. The ownership factor includes the protection of property rights, enjoying monopoly power and controlling the supply of outputs in that country. Second, the term (L) denotes the location factors that determine MNCs’ decisions regarding FDI in developing countries. Location factors can be categorized on the basis of market -and, efficiency-seeking factors for MNCs. The market seeking factors include large market size, easy and small numbers of export/import documents, the least number of days for exporting and importing goods and commodities with reasonable costs to the targeted markets. A large market normally increases the productivity potential of MNCs by achieving economies of scale in the host country. The efficiency seeking factors that matters for FDI include cheap and skilled labor force, soft regulations for easily operation with affordable cost, less capital, limited time, easy and small number of procedures requirements for setting up a business “Starting a Business” in host country. Infrastructure factors including constructions and road networks, communication system, and the electric consumption capacity in the host country are major determinants of FDI (Del Bo, 2009).

#### 4. Method of the study

##### 4.1. Data type and sources

The study used panel data from 14<sup>1</sup> out of 18 East African economies by considering the availability of information on each variable for the period 2010 to 2019. Five countries were excluded from this research as they were missing the required data within the timeframe of 2010–2019.<sup>2</sup> The data are sourced from the World Bank’s World Development Indicators (WDI), Bruegel databases,<sup>3</sup> *doing business* annual reports and Worldwide Governance Indicators (WGI). This study used 10 eases of doing business indicators measured in terms of the distance to frontier (DTF) score. The score is provided by the World Bank and it evaluates the country’s level of business regulatory performance over time by showing the best performance observed for each of the Doing Business indicators. The Worldwide Governance Indicators (WGI) are also a dataset that measures the quality of governance based on different data sources provided by organizations in both developed and developing countries. Good governance is likely to increase the government’s effectiveness in formulating and implementing sound policy reforms.

##### 4.2. Variables descriptions

###### 4.2.1. Dependent variables

The variables used as a dependent are FDI inflow and the economic growth of the county. FDI is an investment that is made to acquire a lasting interest in an enterprise(s) operating outside the investor’s economy (Sothan & Zhang, 2017); (Nangpiire et al., 2018). Based on the existing literature, the logarithm of the net FDI inflow(logfdi) and the log of real GDP of each county (loggdp) are used.

###### 4.2.2. Independent variables

In this study both the Ease of Doing Business (EDB) total score and ten of each indicator score are used as major focal variables that are available for the entire eleven-year period from 2010 to 2019. The score was measured on a scale from 0 to 100, with 0 corresponding to the lowest performance and 100 indicating the highest performance. Specifically, the indicators used are “starting a business,” “dealing with construction permits,” “registering property,” “getting credit,” “protecting minority investors,” “paying taxes,” “trading across borders,” “enforcing contracts,” “getting electricity” and “resolving insolvency.” Details of the factors taken into account by each of the *Doing Business* indicators are listed in Table 3 below.

**Table 3. EDB indicators and its data source**

No	EDB indicators component	Doing business methodology	Acronyms of indicators	Expected signs	Source
1	Starting a Business	Total Score	SB	+	World Bank
2	Dealing with Construction Permits	Score (procedures)	DWCP	+	World Bank
3	Getting Electricity	Score (Cost to get electricity)	GE	+	World Bank
4	Registering Property	Total Score	RP	+	World Bank
5	Getting Credit	Total Score	GC	+	World Bank
6	Protecting Minority Investors	Total Score	PMI	+	World Bank
7	Paying Taxes	Score (Payment per year)	PT	-	World Bank
8	Trading Across Borders	Total Score	TAB	+	World Bank
9	Enforcing Contracts	Score (Cost % of claim)	EC	-	World Bank
10	Resolving Insolvency	Total Score	RI	+	World Bank

**4.2.2.1. Starting a business.** The paid-in minimum capital requirement, time and cost, and the number of procedures required for a small to medium-sized limited liability company to formally operate and start up in an economy is what are measured by starting a business indicator (The World).

**4.2.2.2. Dealing with construction permit.** Procedures, time, and cost to build a warehouse. Even after having a business registered legally, the need to ensure compliance with quality controls and/or environmental standards could hinder a smooth business operation, especially if it is “too much”.

#### **4.2.3. Getting electricity**

Procedures, time, and cost required for a business to obtain a permanent electricity connection for a newly constructed warehouse.

#### **4.2.4. Registering property**

Registering property—Procedures, time, and cost to register commercial real estate. An efficient property registration system reduces transaction costs and minimizes opportunities for corruption and rent seeking.

#### **4.2.5. Access to credit**

Access to credit is the measurement of the strength of credit reporting systems and the effectiveness of collateral and bankruptcy laws in facilitating lending (Hassan & Basit, 2018). **Protecting investors:** Indices on the extent of disclosure, the extent of director liability, and ease of shareholder suits. Laws that protect investors and a court system capable of enforcing the laws are important to expand equity investment.

#### 4.2.6. Paying tax

The paying taxes indicator records the measures of the administrative burden in contributions and paying taxes and also records the mandatory contributions and taxes that a medium-sized company must withhold or pay in a given year (Hassan & Basit, 2018).

#### 4.2.7. Trade across border

Trading across borders—Number of documents, cost, and time necessary to export and import. Doing Business project has investigated the ease of trading across borders focusing on trade and customs regulations and considering traded goods of certain types.

#### 4.2.8. Enforcing contract

The time and cost involved in resolving a commercial dispute is measured by the enforcing contracts indicator through the quality of judicial processes index, a local first-instance court, and by evaluating whether economies have adopted a series of good practices that promote efficiency and quality in the court system (Doshi et al., 2019).

#### 4.2.9. Resolving insolvency

The time, cost, and recovery rate (%) under a bankruptcy proceeding.

#### 4.2.10. Control variables

Foreign investors are determined by their anticipated return on the investment they make, the size of the domestic market available to them, the amount of raw material available, political stability in the country and a conducive investment climate in the country (Agodo, 1978). Moreover, the level of bureaucracy (quality institutions), corruption, exchange rate and the labor market structure also serve as serious impediments for investment inflows ((Bitzenis et al., 2009); (Blonigen, 2005)).

**Table 4. EDB Indicators, FDI and Economic Growth in Eastern Africa**

Variables	Obs	Mean	Std. Dev.	Min	Max
LogFDI	139	8.478023	.9327405	4.74367	9.825908
LogGDP	140	10.0512	.5435436	8.958076	10.82958
DWCP	140	58.41735	14.50199	26.66667	82.50976
EC	140	52.37285	10.80514	32.04614	70.46426
GC	140	7.907143	4.670274	1	19
GE	140	56.18092	20.08216	18.57597	87.92001
PT	140	79.98688	25.98443	0	100
PMI	140	50.85714	27.75758	0	100
RP	140	61.27754	10.26919	40.19684	93.70113
RI	140	34.91081	14.96348	0	69.06471
SB	140	72.05822	14.83445	27.94785	94.50762
TAB	140	53.29838	19.48339	15.44694	87.74397
RERENT	140	7.214828	5.560812	.0011713	24.98767
INF	139	6.795625	5.984576	−2.814698	32.01479
REXR	140	100.7245	32.62277	0	154.3899
OPEN	138	68.78769	41.59166	28.8153	216.4832
AVEGOV	140	34.12803	17.7864	5.303963	77.47997

The main control variables considered in this study are the average composite index of the six governance indicators that help to capture the impact of the governance level. These include political stability and the absence of violence (PV), corruption control (CC), voice and accountability (VA), regulatory quality (RQ), rule of law (RL) and government effectiveness (GE). These six indicators were measured in terms of percentile rankings. The percentile rank shows the country's rank among all countries covered by the aggregate indicator. It is measured on a scale from 0 to 100, with 0 corresponding to the lowest rank, and 100 to the highest rank. Furthermore, other determinants of FDI and growth including trade openness (OPEN), the real effective exchange rate (REER), inflation rate (INF), and total natural resource rent as a percentage of GDP (Rrent) were also used. Five countries have been excluded from this research as they were missing the required data within the timeframe of the years 2010–2019.

#### 4.3. Empirical model

The model used in empirical studies relies on the determinants of each variable to evaluate the impact of ease of doing business on FDI and economic growth. However, there is no consensus regarding the observation of these determinants. This study adopts the economic model of other studies related to the determinants of FDI inflows and economic growth by adding the EDB variable as the variable of interest. In addition, many empirical approaches can be used for cross-country panel data. The fundamental models are ordinary least square, fixed effects, and random effects. The fixed effects model assumes that country-specific effects are correlated with the explanatory variables. On the other hand, the random-effects model assumes that country-specific effects are random and uncorrelated with independent variables. However, the F-test and Hausman test were conducted to determine which econometric model best fit the data. Finally, a fixed-effects model was selected for this study. This can be represented econometrically using Equation (1):

$$y_{it} = \alpha_i + \beta x_{it} + \varepsilon_{it} \quad (1)$$

Where  $\alpha_i$  represents the unobserved time-invariant individual effect and  $\varepsilon_{it}$  represents the error term. Additionally, equation (1) rewritten to include the study variables of interest in equation (2) and equation (3) as follows:

$$\text{Logfdi}_{it} = \alpha_i + \beta_1 \text{EDB}_{it} + \beta_2 \text{GOV}_{it} + \beta_3 \text{open}_{it} + \beta_4 \text{REER}_{it} + \beta_5 \text{inf}_{it} + \beta_6 \text{ReRent}_{it} + \varepsilon_{it} \quad (2)$$

$$\text{Loggdp}_{it} = \alpha_i + \beta_1 \text{EDB}_{it} + \beta_2 \text{GOV}_{it} + \beta_3 \text{open}_{it} + \beta_4 \text{REER}_{it} + \beta_5 \text{inf}_{it} + \beta_6 \text{ReRent}_{it} + \varepsilon_{it} \quad (3)$$

**Where,**  $\text{logfdi}_{it}$  = logarithm of FDI inflow attracted by country  $i$  at period  $t$ .  $\text{loggdp}_{it}$  = logarithm of real GDP of country  $i$  at period  $t$ .  $\text{EDB}_{it}$  = ease of doing business indicators scores of countries  $i$  at period  $t$ .  $\text{GOV}_{it}$  Gov = average governance level index of country  $I$  at period  $t$ .  $\text{open}_{it}$  = trade openness of country  $i$  for period  $t$ .  $\text{REER}_{it}$  = real effective exchange rate of country  $i$  for period  $t$ .

$\text{inf}_{it}$  = inflation rate of country  $i$  for period  $t$ .  $\text{ReRent}_{it}$  = resource rent level of country  $i$  for period  $t$ .  $\beta_1 - \beta_7$  = coefficients of given variables.  $\alpha_i$  = the unobserved time-invariant individual country effect.  $\varepsilon_{it}$  = the error terms.

Moreover, diagnostic tests for multicollinearity, cross-sectional dependence, heteroscedasticity, and autocorrelation were conducted to ensure the validity of the models. According to the works of ((Adepoju, 2017); (Hoechle, 2007)) noted Driscoll and Kraay standard errors was adopted to

account for possible existence of cross-sectional dependence, heteroscedasticity, and autocorrelation in the models.

## 5. Result and discussion

### 5.1. EDB indicators, FDI and economic growth performance in Eastern Africa

From Table 4, it can be seen that variability is higher in the dependent variable LogFDI, as indicated by a standard deviation of 0.932, and there is greater difference in FDI inflows among East African nations for the period under study. While for logGDP, variability is not higher, as indicated by a standard deviation of 0.543. There is no greater difference in GDP growth among East African nations for the period under study. For the explanatory variables, variability was higher, as indicated by a standard deviation; GC had the lowest variability of 4.67, while OPEN had the highest variability of 41.59. It is observed that the East Africa region, as well as the individual East African countries, performed well in terms of business climate indicators (with most indicators registering a score above 50).

A number of diagnostic tests were conducted to check for the presence of multicollinearity, heteroskedasticity, autocorrelation, cross-sectional dependence across the models, panel tests, and regression results. The study undertook a multicollinearity test, and the results showed there is no significant correlation among the explanatory variables. The strongest correlation was observed between SB and PMI (0.74). Therefore, all the explanatory variables are included in the regressions. A Wald test was conducted to check for the presence of groupwise heteroskedasticity, whereas the Wooldridge serial correlation test was used to check for the presence of autocorrelation. The Pesaran test checks for the presence of cross-sectional dependence. As shown in Table 5, the p-value is 0.1497, greater than 0.05, which signifies that there is cross-sectional dependency among the groups, but this problem is not serious in micro panel data (for a few years and a large number of cases). Therefore, the Driscoll and Kraay standard errors are used to correct the estimated standard errors for disturbances. Also, a robust Hausman test proposed by (Wooldridge, 2002) is used to determine the ideal econometric model (fixed or random effects) for each equation and subsample.

Figures 1 and 2 also show the relationship between the average percentage change in GDP, FDI inflows and the World Bank's ease of doing business overall score measure for 14 East African countries. The y-axis is the average percentage growth rate of GDP (ave\_loggdp) and FDI inflows (ave\_logfdi) for each country, while the x-axis is the average overall ease of doing business score. These graphs indicate that, on average, countries with a higher ease of doing business overall score seem to have a positive and high percentage growth in FDI inflow and GDP. In addition, most countries (10 out of 14) have an average EDB score above 50 and a higher growth in FDI inflows and GDP. However, these correlations do not necessarily imply causal relationship. There can be many other crucial factors that influence the outcomes that are not controlled for in these scatter plots. This makes it difficult to judge the significance and robustness of the correlations.

### 5.2. The effect of ease of doing business on FDI inflows and economic growth

This section presents a board analysis of the effect of ease of doing business on foreign direct investment (FDI) inflows and economic growth in East African countries in the year under review. Based on Hausman tests, the fixed effects model is preferred to investigate the EDB effect on FDI, whereas the random effects model estimates were used for analysis in EDB effect on economic growth.

#### 5.2.1. Dealing with construction permits

Dealing with construction permits has a positive and significant relationship in attracting FDI inflows. This implies that an increase in dealing with construction permits by 1 % will cause an increase in FDI inflow for 0.55% in the region between the period 2010–2019. Therefore,

**Table 5. Diagnostics specification tests**

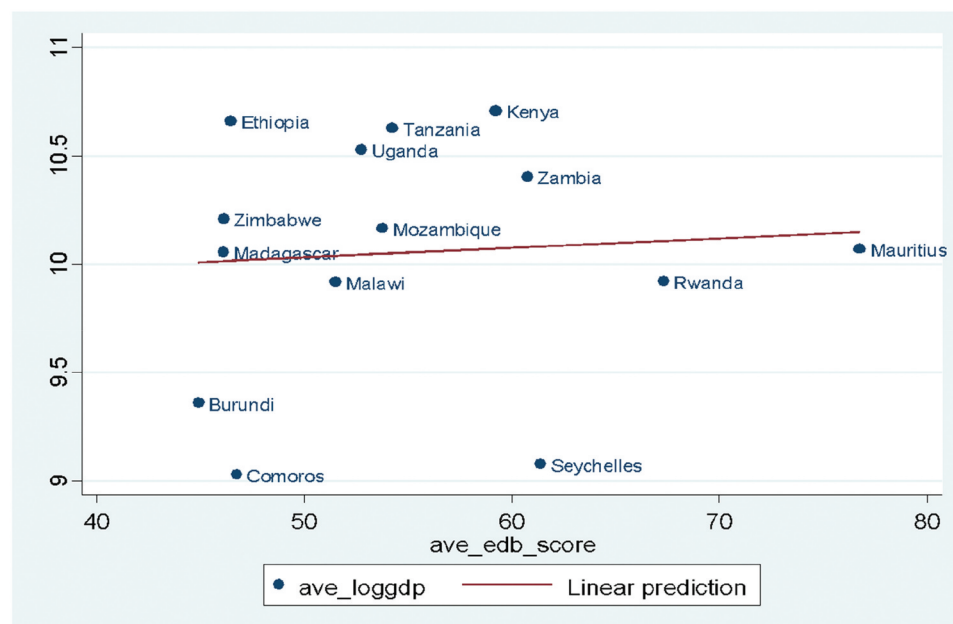
Diagnostic tests	Chi-square and Significance values
Wald test for heteroscedasticity in FE model, $\chi^2$ (14)	618.73 (0.0000)
Breusch-Pagan LM test of independence, $\chi^2$ (14)	-1.441 (0.1497)
Wooldridge test for autocorrelation, F (1, 13)	32.134 (0.0001)
Hausman test Fixed vs. Random effect, $\chi^2$ (15)	105.39 (0.0000)

Note: Numbers in parentheses are P-values

Source: Authors estimation

**Figure 1. Correlation between Countries' EDB Score and Its Change in GDP.**

Source: authors compilation



authorities in the region accelerate the process of obtaining construction permits to win the confidence of investors. This result is inconsistent with the findings of (Olival, 2012), (Shahadan et al., 2014) and (Haliti et al., 2019).

### 5.2.2. Enforcing contract

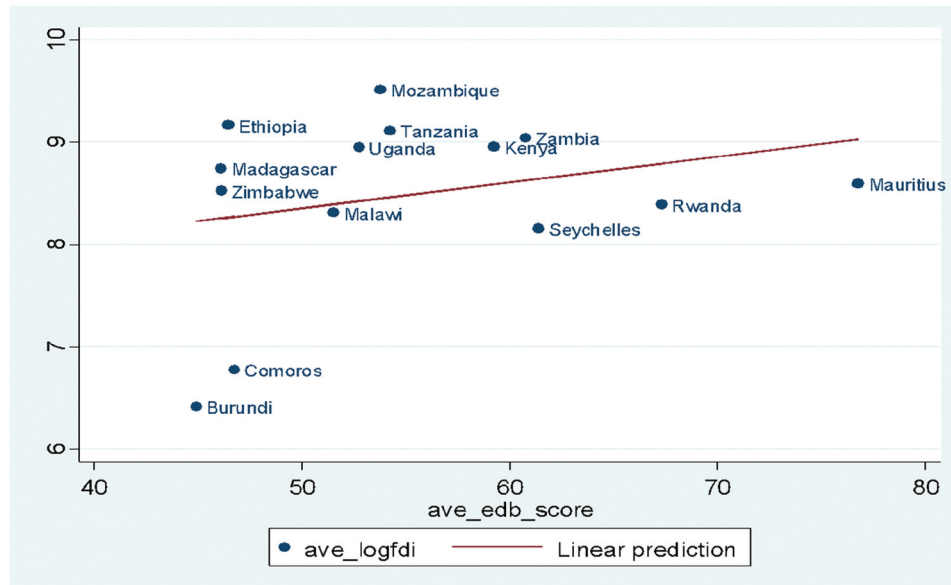
This has a reciprocal and significant effect on FDI inflow. The implication is that a 1 % increase in the enforcement contract index will cause a decrease in FDI inflow by 2.14% between the period 2010–2019 in the region. Thus, enforcing contracts is one of the major factors that deters investments, especially FDI, in East African countries. This finding is consistent with the result of (Anggraini & Inaba, 2020).

### 5.2.3. Getting credit

Getting credit has a negative impact on attracting FDI flows in East African countries from 2010 to 2019. The estimated result implies that increasing credit by 1 percent will cause a decrease in FDI inflow by 2.63%. This finding is contrary to the results of (Shahadan et al., 2014) and (Olival, 2012), but consistent with the finding of (Haliti et al., 2019).

**Figure 2. Correlation between Countries EDB average score and its change in FDI Inflows.**

Source: authors compilation



#### 5.2.4. Getting electricity

Getting electricity has a positive impact on attracting FDI flows in East African countries over years the 2010–2019. Based on these results, it can be concluded that by increasing electricity by 1 percent, FDI inflow increased by 0.56%. This finding is consistent with the result of (Haliti et al., 2019) and inconsistent with those of (Ani, 2015).

#### 5.2.5. Paying tax

Paying tax has a negative and significant impact in attracting FDI flows in the region from 2010 to 2019. This finding is contrary to the results of (Shahadan et al., 2014) and (Olival, 2012) and similar to the results of (Haliti et al., 2019). The implication of the result is that increasing paying taxes by 1 percent will cause a decrease in FDI inflow by 1.26%. Thus, the tax system is not more transparent, and irregularities in the tax allocation and collection systems persist in East African countries.

#### 5.2.6. Protecting minority investors

Protecting minority investors has a positive impact in attracting FDI flows in East African countries over years 2010–2019. The finding is contrary to the results found by (Olival, 2012), (Shahadan et al., 2014) and (Haliti et al., 2019). The result implies that increasing Protecting minority investors by 1 percent will cause an increase in FDI inflow for 0.9%. Thus, efforts have been made by authorities to ensure the personal security of individuals and their property as well as the judiciary systems are fair and transparent so as to win the trust of investors in the region.

#### 5.2.7. Trade openness

Trade openness shows a significantly positive impact on FDI inflow in the region during the period 2010–2019. The implication is that a 1 percent increase in trade openness causes an increase in FDI inflow by 1.01%. This finding is contradicting the results of Sultanuzzaman et al. (2018) and (Anggraini & Inaba, 2020).

#### 5.2.8. Average governance indicators

Average governance indicators have a positive impact on FDI inflows in East African countries. The coefficient of estimation reflects that a 1% increase in the average governance indicator will lead to an increase in FDI inflow by approximately 3.03% over the year 2010–2019. This finding is consistent with that of (Anggraini & Inaba, 2020). The works of Shahzad and Qin (2019), Shahzad et al. (2020), Zulfiqar et al. (2014), and Zulfiqar et al. (2014) discussed that terrorism attacks



decrease capital inflow which mean that international investors are not willing to invest in unstable political and governance systems.

The pooled panel regression results show the effects of the ease of doing business total score on FDI inflows in East African countries over the year 2010–2019. The results point to the fact that the EDB total score, openness, and the constant are significant variables, while the resource rate, inflation, and real exchange rate are marginally insignificant variables for the model log FDI.

#### 5.2.9. EDB total score

EDB (overall score), has a positive impact on FDI inflow. Based on the estimated results, a 1% increase in the overall EDB causes an increase in FDI inflow by 3.09% in the region. This signifies that many tasks were performed to improve the overall EDB score and attract FDI in the region. This finding is consistent with those of previous studies by (Corcoran & Gillanders, 2015), (Jayasuriya, 2011) and (Anggraini & Inaba, 2020).

#### 5.2.10. Inflation rate

This has a significant and positive impact on FDI, based on the estimation result at a 1% level of significance. The coefficient of estimation reflects that a 1% increase in the inflation rate will lead to an increase in FDI inflow by 3.66%. This signifies that a moderate inflation rate attracts FDI inflow in the region. This finding is consistent with the study by (Anggraini & Inaba, 2020).

Moreover, the real effective exchange rate has a significantly positive relationship with growth of GDP indicating that an increase or appreciation in the real value of the currency play a positive role in these countries' economies. A 1% increase in real effective exchange rate leads to a rise in GDP by 0.1 percentage points.

Table 6, also provided the main empirical results for relationship between the variables of interests and economic performance. The estimated coefficient values and their significance levels were obtained using a fixed-effects model specification with Driscoll-Kraay robust standard errors. The estimated coefficient of the most of business reforms variables (6 of 10) remains statistically significant indicating their effects on the economies of the region. Getting credit, resolving insolvency, and starting a business are positively and significantly related to the percentage change in GDP, whereas enforcing contracts and protecting minority investors have a significantly negative effect on the percentage growth of GDP in these countries. Whereas the variables of dealing with construction permit, getting electricity, paying taxes, registering property, and trading across border has not shown any significant impact on the change in GDP.

The findings pointed out in Table 6 is that a one percentage point increase in getting credit will increase the growth of GDP by approximately 0.5 percentage points. It is notable that this result consistent with Bonga and Mahuni (2018) and inconsistent with Estevão et al. (2020), Adepoju (2017), and Ani (2015). The estimates also suggest that a one percentage point increase resolving insolvency will increase GDP growth rate by approximately 0.5 percentage points. This finding is consistent with Estevão et al. (2020) and inconsistent with Bonga and Mahuni (2018). The results also noticed that a one percentage point increase in business startup associated with a 0.4 percentage growth in GDP. This result is inconsistent with the findings of Adepoju (2017)

In contrast, a one percentage point increase in enforcing contracts and protecting minority investors is estimated to reduce the growth of GDP by approximately 0.2 percentage points respectively. In addition, the results for the average governance level have significantly negative relationship with GDP growth. The coefficient estimates show that a one-percentage-point increase in governance level will decrease GDP by approximately 0.2 percent. This result is also consistent with the findings of Adepoju (2017). Over all It is notable that this study strengthens the argument that the effects of the *Doing Business* indicators may be different for different groups of countries.

**Table 6. Effects of ease of doing business indicators on FDI inflows and economic growth**

<b>Independent Variable</b>	<b>Dependent Variable (logFDI)</b>	<b>Dependent Variable: (logGDP)</b>
Constant	<b>5.820497***</b> (1.017851)	<b>9.569***</b> (0.140)
Dealing with Construction permits	<b>0.0054892***</b> (0.0016999)	0.000 (0.001)
Enforcing contracts	<b>-0.021397***</b> (0.0052308)	<b>-0.002**</b> (0.001)
Getting credit	<b>-0.0263388***</b> (0.0092639)	<b>0.005**</b> (0.002)
Getting electricity	<b>0.0056464***</b> (0.002379)	0.001 (0.000)
Paying taxes	<b>-0.0126403***</b> (0.0047973)	0.000 (0.000)
Protecting minority investors	<b>0.0089712***</b> (0.0037501)	<b>-0.002***</b> (0.000)
Registering property	0.0162025 (0.0091492)	0.000 (0.000)
Resolving Insolvency	0.0034261 (0.0066345)	<b>0.005***</b> (0.001)
Starting a business	0.0190922 (0.0087713)	<b>0.004***</b> (0.000)
Trading Across Borders	-0.001406 0.0022593	<b>0.000***</b> (0.000)
Governance level, average	<b>0.0303467***</b> (0.0119863)	<b>-0.002**</b> (0.000)
Resource rent	-0.007855 (0.0170947)	-0.003 (0.000)
Inflation rate	-0.001202 (0.0052391)	0.001 (0.001)
Real effective exchange rate	-0.0019151 (0.0052351)	<b>0.001**</b> (0.000)
Openness	<b>0.0101204***</b> (0.002974)	0.000 (0.000)
Number of observations	137	138
Number of countries	14	14
F-Statistic	135.84***	162.09***
R-squared (within)	0.2770	0.7841

Note: \*10% \*\*5% and \*\*\*1% levels of significance respectively. The numbers in the parenthesis are Driscoll-Kraay standard errors.

Table 7, above indicates that the overall EDB score has a positive impact on GDP growth. The magnitude of the impact of a 1% increase of overall EDB total score on GDP is approximately 2.24%. This result similar to urban\_benedikt (2019), which shows that improvement in EDB score triggers the growth of manufacturing GDP. Resource rents and inflation rates have a positive impact on GDP, whereas openness negatively correlates with changes in GDP. Based on the estimation results, the magnitude of the impact of a 1% increase in resource rents and inflation on GDP is approximately 0.8% and 2.3% respectively. A 1% increase in trade openness decreases GDP by approximately 0.65 percent. The positive sign of the coefficient of resource rents may indicate investors resource-seeking motivation. The positive sign of inflation supports the neoclassical arguments that an increase in the inflation rate will reduce the real interest rate and create a lower rate of the cost of capital, and then investment activities become more profitable, more income can be generated. Hence, the moderate level of the rate of inflation has positive effects on economic performances of countries.

**Table 7. Effects of ease of doing business total score on FDI inflows and Economic Growth**

Independent Variable	Dependent Variable: (logFDI)	Dependent Variable: (logGDP)
Constant	<b>6.480882***</b> (0.1506212)	<b>9.139541***</b> (0.1162978)
EDB total score	<b>0.0309731***</b> (0.0037162)	<b>0.0224057***</b> (0.0030053)
Resource rent	0.0085292 (0.018322)	<b>0.0080807***</b> (0.0033645)
Inflation rate	<b>0.0366253***</b> (0.0155117)	<b>0.0233755***</b> (0.004109)
Real effective exchange rate	-0.0004776 (0.000876)	-0.0008666 (0.0011598)
Openness	0.0005417 (0.0004708)	<b>-0.0065807***</b> 0.0001198
Number of observations	137	138
Number of countries	14	14
F-Statistic	<b>128.03***</b>	<b>2426.75***</b>
R-Squared(within)	0.1206	0.3095

Note: \* $p < 0.1$  \*\*  $p < 0.05$  \*\*\* $p < 0.01$ . The numbers in the parenthesis are Driscoll-Kraay standard errors.

The trade openness coefficients imply there is a significant trade barrier and a lower rate of market competition in the region's economies which contribute to change in GDP. Moreover, the real effective exchange rate has a significantly positive relationship with growth of GDP indicating that an increase or appreciation in the real value of the currency play a positive role in these countries' economies. A 1% increase in real effective exchange rate leads to a rise in GDP by 0.1 percentage points. This findings also consistent with the works of Sultanuzzaman et al. (2018) and Sadiq et al. (2021)

## 6. Conclusion and policy implication

### 6.1. Conclusion

The main goal of this study was to examine how business regulation climates affected FDI inflow and economic growth in East African countries using the World Bank index over the period 2010–2019. According to the findings of our study, dealing with construction permits, enforcing contracts, getting credit, getting electricity, paying tax and protecting minority investors are the primary ease-to-do business indicators that have a favorable and significant impact on attracting FDI inflow in East African countries. Enforcement a contract, obtaining credit, protecting minority investors, resolving insolvency, starting a business and trade across borders are the main ease of doing business indicators that have a positive and significant impact on economic growth in the region. Therefore, in the region, the ease of conducting business indicators has a considerable impact on foreign direct investment and economic growth. Among the instrumental variables, only trade openness and governance quality indicators have a positive impact on FDI inflow in the region, whereas other variables have no impact on FDI inflow in the region. All control variables, except the real exchange rate have a significant impact on economic growth in the region.

Moreover, as indicated by the coefficients of individual EDB indicators and the total score, there is evidence of sizable positive impacts of ease of doing business regulatory reforms on FDI inflows and growth in the region. Each additional reform during 2010–2019 is associated, on average, with a 3.09% increase in FDI inflows and a 2.24% increase in GDP in East African countries. Thus, this study indicates that business regulations are a significant factor in FDI inflows and GDP in region's economy. As a result, these findings suggest that policymakers should be given substantial

considerations to the design and implementation of business regulation reforms in order to maintain FDI inflows and GDP growth.

### 6.2. Policy implication

Our findings have some implications for economic policies. This finding suggests that reforms that improve the business environment can help poor nations grow faster. Reform programs should stimulate companies to change their behavior, enhance investment, and encourage innovation. Economic policymakers should reduce business costs and risk and increase competitive pressure by improving administrative and fiscal policies, access to finance, legislation and labor administration, and access to information on the market. Each country should examine the criteria for the business environment separately. The findings of this study will help policy makers adjust their ease of doing business procedures to attract FDI to their economies. This will also assist investors in monitor these key indicators to facilitate investment decisions in foreign countries.

The findings of our study will help policymakers in the region establish a strong legal framework for business regulations to attract FDI inflow into their economies and promote regional economic growth. It will also assist investors into keeping track of these indicators to facilitate their investment decisions in East African countries.

### 6.3. Limitations of the study and future research direction

The findings of this study have some limitations, which can also serve as opportunities for further exploration. Because the Doing Business project methodology and components are continually evolving, policymakers in the region need to consider indicators of EDB in creating a strategy for attracting more FDI inflow. Although only a few indicators of ease of doing business have a major impact on FDI inflow and economic growth, policymakers and governments should concentrate on increasing the ease of doing business indicators. Another study might be undertaken to cover all countries in the East African region, utilizing country rankings as a variable for each doing business indicator, while the current study only covered 14 countries using distance-to-frontier scores for each indicator. Other FDI inflow and economic growth measures can be used. Additionally, more in-depth research into business and economic growth can be conducted over a longer period. Nonetheless, this study serves as an essential policy guide that East African countries should have at their disposal to maximize FDI inflows and promote regional economic growth.

Furthermore, it is necessary to understand why some nations have not improved their business climate. This might be as a result of the complexities and uncertainties surrounding the cost of implementing reforms. We could say that such costs have an impact on business regulations, FDI, and the growth nexus. Further research is needed to investigate this effect. additionally, the analysis included recent data and the time period was characterized by the Covid crisis. There could be further revealing results if the period is split into pre- and post-crisis periods. This might be feasible since the “Doing Business” dataset is regularly updated. This study used data from Eastern African countries, and, as such, the findings presented here should be considered tentative. Caution is therefore required to generalize these findings beyond the sample and countries used.

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#### Notes

1. Country included in the sample are Burundi, Comoros, Ethiopia, Kenya, Malawi, Madagascar, Mozambique, Mauritius, Rwanda, Seychelles, Tanzania, Uganda, Zambia, and Zimbabwe.
2. Excluded countries are; Djibouti, Eritrea, Reunion, Somalia, and South Sudan
3. Bruegel is a European think tank that specializes in economics. The real effective exchange rate data is sourced from this database.

#### Disclosure statement

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