Research in International Business and Finance 39 (2017) 239–247

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Full length article

Foreign direct investment and environmental sustainability in Africa: The role of institutions and governance

Godfred A. Bokpin

Department of Finance, University of Ghana Business School, College of Humanities, University of Ghana, P.O. Box LG 78, Ghana

ARTICLE INFO

Article history:
Received 2 March 2016
Received in revised form 26 July 2016
Accepted 28 July 2016
Available online 30 July 2016

Keywords:
FDI
Environmental sustainability
Governance
Institutions
Africa

ABSTRACT

The African continent continues to explore more avenues to increasing its share of the global FDI inflows. In the midst of all these, very little has been said about how FDI among others contribute to the environmental degradation of the continent. Literature is sparse when it comes to how eco-unfriendly FDI flows could be, albeit it's economic growth prowess. In this very study, we employ the use of a 24 year panel data (1990–2013) across Africa to investigate the impact of FDI inflows on the eco-system in order to situate Africa's FDI flows within the sustainability development agenda popularized in the 80s. For the first time, we investigate how governance and institutions may regulate the impact of FDI on environmental sustainability. We do this conscious of the fact that other factors could also impact negatively on Africa's eco-system which we control for in the empirical model. The empirical results compositely reveal an increase in FDI inflows significantly increases environmental degradation; hence causing a negative impact on sustainability of the environment. Year dummies indicate that environmental degradation in the post 2010 era is greater than degradation in 1990 which was used as the reference point. The study affirmed that, for FDI to have a positive impact on environmental sustainability, there need to be strong governance and quality institutions in place to check the conduct of businesses financed through the FDI flows. The study provides empirical evidence to anchor governance and institutional policy prescriptions towards reducing the negative impact of FDI flows on environmental sustainability within the sustainable development preposition.

1. Introduction

It is almost becoming a cliché that FDIs to a very large extent, influence the economic prospects of recipient nations positively. On annual basis, Sub-Saharan African countries receive significant amounts of FDI from other parts of the world. Even in 2008 when the global financial crisis was just about happening, FDI flows to Africa grew strongly. Sub-Saharan Africa (SSA) received about \$64 billion representing 5.2% of global FDI (World Bank et al., 2011). With the occurrence of the crisis, FDI flows to Africa recorded a fall of less than 15% in 2011 (United Nations Conference on Trade and Development, 2011). Although the figures show that Africa has and continues to receive FDIs, there are still more that could be done to attract many more FDIs into the sub region. In their quest to increase the flow of FDIs into the region, many African countries are making mammoth efforts to facilitate and increase the inflows of FDI by embarking on wide-ranging policy changes, such as political and institutional reforms to remove barriers to trade and FDI inflows (Cleeve, 2012). Some studies (see Ayadi, 2009;

E-mail address: gabokpin@ug.edu.gh

http://dx.doi.org/10.1016/j.ribaf.2016.07.038

Ayadi et al., 2010) argue that Trade and investment liberalization, privatization, and investment incentives have received considerable attention via structural adjustment and austerity programs under the auspices of the International Monetary Fund (IMF) and World Bank (WB) to attract FDI, which in turn was expected to stimulate economic growth, generate new employment opportunities and facilitate the transfer of technology.

What appears to have been missing in the argument is how these institutions ensure that the increase in FDI flows to the continent does not compromise the environmental sustainability of the African continent which has become necessary, given the popularization of the sustainable development preposition in the 80s. While the subject of FDI has received and continues to receive several attention in the literature, very little is known about how FDI flows affect the African environment. This development highlights the need to place the FDI-economic growth debate within the sustainability context as first made popular by the Brundtland and World Commission on Environment Development (1987) and the need to adopt a strong sustainability position for the discussion and implementation of the post-2015 sustainable development policies as opined by Pelenc et al. (2015). This is particularly so because, there is ample evidence to reasonably suggest that the flow of FDI into the sub region may have some environmental repercussions. There have been several debates on the consequences of FDI for less-developed countries especially in the area of macrosociology and its sister disciplines (see Hoffman et al., 2005; Kentor and Boswell, 2003). Emerging literature has it that, FDI inflows may contribute to different forms of pollution and environmental degradation in less-developed countries (e.g. Jorgenson, 2007, 2009a,b; Jorgenson et al., 2007). Some studies argue that, in recent years, many less-developed countries experienced a deepening of foreign debt, which resulted in austerity measures developed by global governance institutions (McMichael, 2004). These austerity measures are often required to encourage the governments of indebted countries to create more favorable operating environments for foreign investors and transnational corporations. These conditions have often times included tax reductions or exemptions and relaxed labor laws, as well as exemptions to environmental regulations designed to protect the natural environment from productive and extractive activities in different sectors of the economy (e.g. Jorgenson, 2009a,b; Clapp and Dauvergne, 2005; Leonard, 1988; Shandra et al., 2008). With the relaxation of some of these environmental regulations, many comparative sociologists (e.g. Grimes and Kentor, 2003; Jorgenson et al., 2007) posit that, a large proportion of FDI inflows to less-developed countries finances highly polluting and ecologically inefficient manufacturing processes and facilities, much of which are outsourced from developed countries. Given the not far reaching negative implications of some FDI inflows, it is important that we reexamine the nature of FDI inflows into Africa to find out how such foreign capital inflows have led to environmental degradation in forms that include pollution of water bodies, toxic substances emission, and deforestation. This study therefore investigates the effect of FDI inflows on the environmental sustainability of Africa. Till date, it is not clear whether FDIs into Africa have been eco-friendly.

H1. FDI inflows has a negative impact on Africa's environmental sustainability agenda

Crucial to the FDI-environmental sustainability relationship is the role of institutions and governance. Foreign capital flows will naturally be directed towards areas where there are less restrictions, in order to maximize returns. However, it is the role of government and its allied institutions to ensure that the negative repercussions of FDI are contained within a regulated framework, so as not to cost the environment so much in an attempt to fix the economy. Some studies have already laid the foundation of the debate that the state has a role in buffering the potentially detrimental impacts of foreign investment dependence (e.g. Bornschier and Ballmer-Cao, 1979; Lee et al., 2007). Some studies have sort to document that in the midst of FDI flows, the environmental protection could be enhanced with increased state responsiveness and high concomitant policy capacity (Ehrhardt-Martinez et al., 2002; Fisher and Freudenburg, 2004). This means that the strength of state institutions such as environmental protection agencies, and their governance structures may influence how FDI affect environmental sustainability. We therefore employ the use of an interactive term to test the moderating role of governance and institutions in the relationship between FDI flow and environmental sustainability.

H2. Relatively strong governance institutions mitigate the effect of FDI on environmental sustainability in Africa.

In this study, we used a panel data methodology to empirically test our two main hypotheses which will lead to a documentation of the impact of FDI inflows on environmental sustainability and how strong institutions may mitigate such negative repercussions.

In this study, we document the impact of foreign capital inflows on environmental sustainability in Africa and the moderating role played by governance and institutions in such relationship. Enough attention has already been given to the determinants of FDI inflows and several efforts are being made to promote same. It is very important that we find ways of ensuring that, the promotion of FDI inflows does not hurt the eco-system of the African continent, and thereby contradicting the sustainability development agenda popularized in the late 80s. To this, we explore the impact of FDI inflows and the moderating role of institutions on environmental sustainability, while controlling for other country-specific factors capable of influencing environmental sustainability.

1.1. FDI and environmental degradation in Africa

FDI is known in the standard literature to have a lot of positive effect on the host country including real exchange rate (see Choi and Jeon, 2007), economic growth via capital investment, technology and management, boost corporate social responsibility activity. But FDI is also known to have detrimental effect on the environment. This was made more manifest