EFFECT OF SELECTED FISCAL POLICY INSTRUMENTS ON FOREIGN DIRECT INVESTMENT INFLOW IN KENYA

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A Thesis Submitted to the School of Business and Economics in Partial Fulfillment of the Requirements for the Award of the Degree of Master of Science Economics of Masinde Muliro University of Science and Technology

NOVEMBER, 2024

DECLARATION

This thesis is my original work prepared with no other than the indicated sources, and support, and has not been presented elsewhere for a degree or any other award.

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CERTIFICATION

The undersigned certify that they have read and hereby recommend for acceptance of Masinde Muliro University of Science and Technology a thesis entitled **"Effect of Selected Fiscal Policy Instruments on Foreign Direct Investment Inflow in Kenya"**

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DEDICATION

I devote this project to my family; Robert Makatiani, Phaustine Lungatso and Victor Makatiani who have been of great support throughout my education. I also dedicate it to my friend Edward Achola who has played a vital role in moral support**.**

ACKNOWLEDGEMENT

I acknowledge God the Almighty, for His ever-abundant grace and my well-being in the course of my studies. Special gratitude to my university supervisors Dr. Consolata Ngala and Dr. Angela Mungai for their education and constructive critique.

I would like to express my sincere gratitude to Mercy Nyakangi and Alavitsa Ruth for their invaluable contributions to the completion of this academic document. Their technical expertise and moral support were instrumental in motivating me to work diligently and achieve the success of this study. Their assistance, both direct and indirect, has been greatly appreciated.

ABSTRACT

Foreign Direct Investment serves as a crucial connection between developing and industrial nations. In Kenya, a substantial obstacle looms in the form of a formidable challenge: the nation grapples with drawing and maintaining Foreign Direct Investment (FDI) at rates imperative for unlocking the full potential of associated capital inflows and harnessing the benefits of global integration and technology transfer. Despite the widely acknowledged significance of FDI, the country finds itself struggling to cultivate an environment conducive to optimal FDI inflow. This deficiency not only hampers domestic investment opportunities but also significantly impedes the realization of robust economic growth. The need to tackle this problem is intensified by the incomplete knowledge of how fiscal policy tools impact FDI inflows in Kenya, highlighting the importance of a concentrated analysis. The main aim of the research was examine the how selected fiscal policy tools impacted the flow of cross border direct influx into Kenya between 2002 and 2021. This study aimed to investigate four key objectives: to establish how tax incentives impact foreign direct investments in Kenya, to examine the impact of recurrent expenditure on foreign direct influx in Kenya, to determine the impact of external debt on international capital investment in Kenya, and to examine how currency exchange rates moderate the relationship betwixt fiscal policy instruments and foreign international investment in Kenya. The study focused on the period 2002-2021 because this is the period where Kenya had persistent international capital Investment, especially after the 2008 post-election violence, global economic recess, and the COVID-19 pandemic. Descriptive, correlation and causal research design were adopted. Secondary time series data from the World Bank, UNCTAD, Macroeconomic, IMF and Government Finance Statistics from CBK, Tax Expenditure Reports, and KNBS collected through document analysis was used in the study. Descriptive statistics computed using E views software were computed to observe the general trend of sampled variables. Correlation analysis results showed a moderate positive correlation ($r = 0.573509$) between Tax Incentives, Recurrent Expenditure ($r = 0.516856$), and Currency Exchange Rate ($r = 0.391773$) with FDI Inflow. It also showed a moderate inverse relationship ($r = -0.457851$) between External Debt and FDI Inflow. The Augmented Dicky Fuller (ADF) test showed that External Debt was stationary at levels 1(0), while FDI Inflow, Tax Incentives, current Expenditure and forex Rate were found to be stationary at the first difference 1(1). During post-estimate test diagnostic, the Breusch-Godfry Test showed there was no serial autocorrelation present in the regression residuals. Additionally, the Breusch-Pagan-Godfrey Test indicate the absence of heteroscdasticity in the equation. Furthermore, the Jarque-Bera statistics test indicated that the regression residuals were normally distributed. The regression model estimates indicated that a unit growth in incentive tax would increase FDII by 29.0502 percent at $p = 0.0002 < 0.05$ holding significant other factors constant. A unit increase in in recurrent expenditure would increase FDI by 25.7703 percent at $p = 0.288 < 0.05$ significantly holding other factors constant. It also shows an unit increase in external debt would decrease FDI inflow by 45.7851 percent at $p=0.0061 < 0.05$) significantly citeris paribus. Results further indicated a statistically significant positive intervening influence of currency rates of exchange on the association between explanatory variables and the dependent variable. To enhance the flow od global Investment, the research suggested that policymakers should customize incentives to boost investor trust and the government should implement measures to guarantee that a significant part of regular spending encourages activities that support FDI Inflow. Policymakers should prioritize strategies to manage and reduce external debt burdens responsibly.

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LIST OF ABBREVIATIONS AND ACRONYMS

CBK	Central Bank of Kenya
CIT	Corporate Income Tax
CEIC	Census and Economic Information Center

FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
KIA	Kenya Investment Authority
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Square method
SPSS	Statistical Package for Social Sciences
UNCTAD	United Nations Conference on Trade and Development
WIR	World Investment Report

OPERATIONAL DEFINITION OF KEY TERMS

Corporate Income Tax Expenditure	Deductions designed to encourage companies to invest in productive fixed assets
Exchange rate	The atrate which one country's currency is changed for another, taking into consideration price and earnings variations between the two countries.
External Debt	Loans are taken by the Government from external sources when current revenue falls short of public expenditures.
Foreign Direct Investment	Firm or individual Investments made in one country that is not their home country.
Gross Domestic Product	The total monetary or value market of all finished products and services produced within a given period country's boundaries.
Recurrent Expenditure	All payments, except for capital assets, include products and services, payments, subsidies, and transfers.
Tax expenditures	Tax measures that differ from an established baseline tax structure.
Tax incentives	Government-provided reduction in taxes or other favorable tax treatment designed to encourage specific

behaviors, activities, or investments that align with public policy goals.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Under the Organisation of Economic Cooperation and Development (OECD) and the International Financial system (1996), Foreign Direct Investment (FDI) is known to be "A category of investment that represents the purpose of creating an enduring stake by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor" .

Foreign direct investment benefits both host nations and multinational firms. It delivers more financial resources to the host countries via taxation and investment Emako et al (2022). In addition to creating jobs, foreign investment has knock-on effects like the transfer of technology, management expertise, skill sets and corporate governance standards (Vann,2021). Multinational corporations and other organizations simultaneously acquire access to low-cost labour, natural resources peculiar to a certain location, markets, and the chance to profit from bilateral and multilateral trade policy (Velde, 2019).

In the global context, FDI inflows have become a factor in shaping the economic-based landscape of nations. The liberalization of trade and investment policies and globalization have created opportunities for cross-border investments, fostering economic integration and interdependence (UNCTAD, 2020). Global foreign direct investment rose to Ksh 239.76 trillion ($ 1.582) in 2021, significantly surpassing Ksh 215.97 trillion ($1.425) inflows in the pre-crisis period 2005-2007 and Ksh 31,068.69 billion ($ 205 billion,) in 1990 (UNCTAD,

2022). According to the UNCTAD (2021), global FDI inflows declined by 35% in 2020, reaching Ksh 151.55 trillion ($1 trillion), significantly impacted by the COVID-19 pandemic.

In Africa, FDI flows soared to Ksh12.45 Trillion ($83 billion) in 2021, marking a substantial jump from the Ksh 5.85 Trillion ($39 billion) recorded in 2020 (UNCTAD, 2022). While many recipient nations experienced a modest uptick in FDI, it's worth highlighting that the continent's total was significantly influenced by a substantial intra-firm financial transaction. Despite a lackluster performance in greenfield announcements, the region saw a remarkable 26 percent increase in international project finance deals, with a particularly robust expansion in the extractive industries, contributing to the overall positive trajectory of FDI in Africa. (World Investment Report, 2022)

Developing countries have emerged as attractive investment destinations, offering potential markets and abundant resources. Within the East African region, FDI inflows have been dynamic, with countries like Tanzania, Uganda, and Rwanda witnessing substantial investments (UNCTAD, 2022). However, Kenya, despite its strategic location, skilled labour force, and diverse sectors, has faced challenges in attracting significant FDI inflows. The country's FDI landscape has been influenced by factors like political stability and infrastructural development, regulatory framework, market size and the human capital. The country has witnessed fluctuations in FDI inflow over the years, influencing its economic development. (UNCTAD, 2022). The table shows the trends in FDI inflow in Kenya

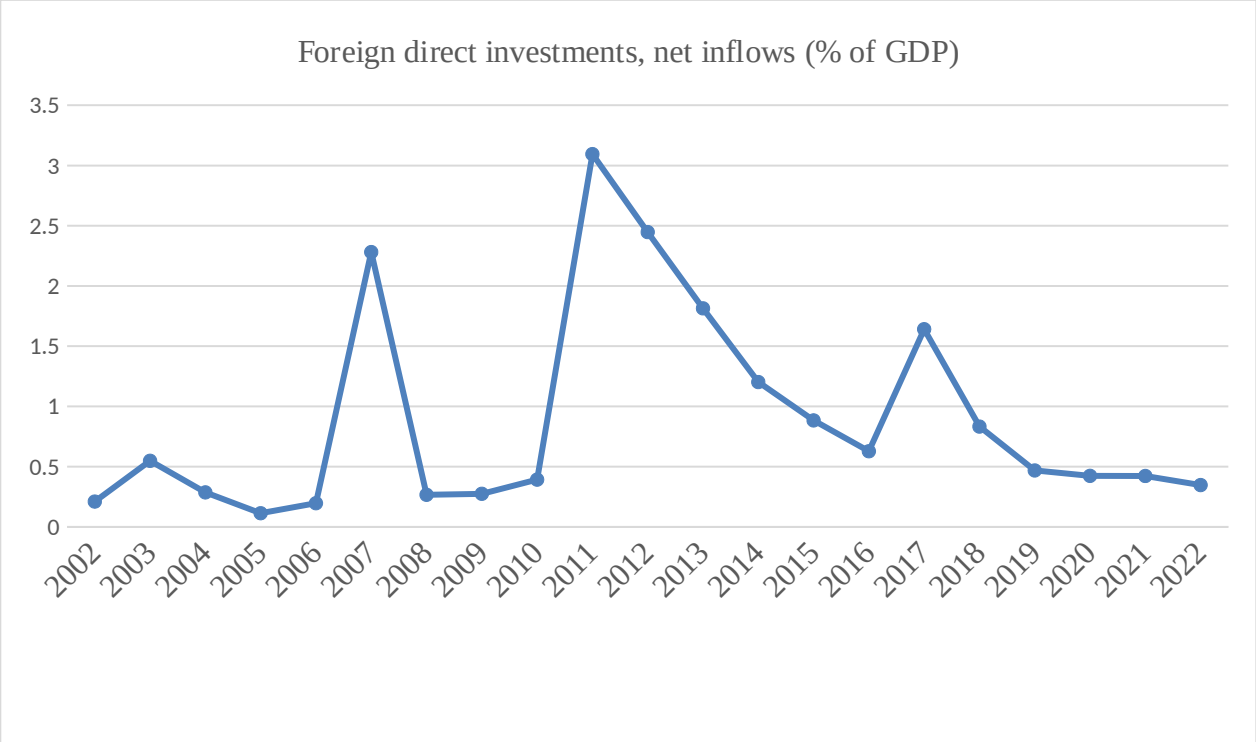

Figure 1.1: Trends of foreign direct investment (FDI) inflows in Kenya (2002-2022)

Source: World Bank database- World Development Indicators 2022.

FDI in Kenya has had a tumultuous history, as depicted by the significant decline in 2004, followed by a gradual increase starting in 2005 (refer to figure 1.1). Despite the progress made, the country is still vulnerable to external economic shocks, which have negatively impacted the economy (UNCTAD, 2021).

Kenya continues to see relatively little foreign investment given the size of its economy and degree of development (Odhiambo, 2022). Nonetheless, Kenya remains one of Africa's leading recipients of FDI. According to UNCTAD 2022, FDI flows to Kenya fell to Ksh 67,896.46 million ($452 million) in 2021 from Ksh 108,664.65 million ($724.431 million) in 2020, the lowest amount in the prior five years. During the same year, total FDI stock stood at Ksh 1,576.17 billion ($10.506billion), amounting to only 9.5% of the country's national output.

Acording to the National Bureau of Statistics of Kenya (KNBS, 2021), the economy of the nation remains vulnerable to external economic uncertainties, which pose a risk to the substantial progress it has made. Encouraging foreign direct investment (FDI) in Kenya can be achieved through implementing structural reforms that enhance the business environment, foster accelerated growth, and stimulate savings (Ernst and Young, 2017). These reforms should encompass tax and expenditure measures aimed at increasing both savings and investment.

Developing nations are depending more and more on investment incentives to draw in capital and shape their actions (Haundi et al, 2020). Out of 107 third-world nations, more than 50 percent offered national corporation tax holidays or favourable prices across industries as of 2015, 46 per cent of them implemented increased the size of already-existing ones between 2009 and 2015 (Andersen, Kett, and von Uexkull 2018). Corporate tax incentives are becoming a growing trend, in part because of the competition to draw in foreign direct investment (World Bank, 2015).

To entice FDI, the Kenyan government has been providing range of tax benefits. Nevertheless, recent research reveals that these tax incentives are resulting in substantial revenue losses and may not be necessary to attract FDI (Camara, 2023). The provision of tax incentives in Kenya is also driven by tax competition within the East African Community (EAC), where Member nations are inclined to raise incentives to draw foreign direct investment, which could result in detrimental tax competitiveness and possibly "race to the bottom." (Wachira et al., 2012; Baker, 2016). However, the effectiveness and impact of these incentives are not felt, considering their revenue implications and the overall welfare of the population (Wachira et al., 2012; Baker, 2016). Kenya's tax-to-GDP ratio stood at 15.2 percent in the 2021/22 period, this remains relatively high compared to regional benchmarks,

with Uganda at 13.9 percent and Tanzania at 11.8 percent (Revenue Statistics in Africa, 2023).

To attract investments, Kenya has implemented significant changes to its corporate tax policies over the years. Motivated by the necessity of competing for foreign investments, the main objective of these measures has been to lower the coporate income tax (CIT) and increase corporate tax expenditures (Wanjala, 2020). Consequently, CIT rates have been reduced from a high of 45 percent in 1989 to the current rate of 30 percent. Kenya also differentiates CIT rates between foreign-owned and locally-owned companies, typically imposing higher rates on foreign-owned firms to encourage domestic ownership (Wabiga, 2020). Kenya has used its CIT system to support an export-led industrialization strategy concerning tax incentives (Njoroge, 2021). This strategy involves creating an excise tax structure intended to encourage investments in the production of items that are competitive in export markets, as well as zero-rating the raw materials from VAT (Wanjala, 2020).

The Sub-Saharan region experienced a notably faster growth rate in external debt in 2018 compared to other regions. Aggregate external borrowing surged by 15.5 percent between 2018 and 2019, surpassing the 10.2 percent growth observed in low- and middle-income regions during the same period. Some countries within the region saw even more substantial increases. Between 2010 and 2018, Ethiopia, Cameroon, Rwanda, Zambia, and Uganda witnessed external debt spikes exceeding 200 percent. Ghana, Kenya, and Liberia also recorded increases of over 140 percent in their external debt levels (IMF, 2018). This significant expansion of external debt has raised concerns regarding its potential negative impacts on investor confidence and the foreign direct investment (FDI) influx.

As stated in 2020 Economic Survey, total public debt of the country has exhibited a consistent upward trajectory, largely attributed to extensive borrowing for infrastructure development and budgetary support. This increasing debt burden has raised concerns about fiscal sustainability and macroeconomic stability, potentially influencing foreign investors' perceptions (World Bank, 2020).

Notably, as Kenya's debt levels have risen, there has been a need for higher revenue generation, leading to adjustments in tax policies (Kenya Revenue Authority, 2021). Such shifts impact FDI by altering the overall business environment. While certain levels of borrowing can be conducive to growth, excessive debt can deter FDI due to increased risk perceptions and potential macroeconomic vulnerabilities (International Monetary Fund, 2019). This situation highlights the intricate relationship between external debt and FDI, underscoring the necessity of maintaining a balance between funding for development and economic stability to ensure sustained foreign investment inflows.

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1.2. Problem Statement

Foreign Direct Investment in Kenya has shown an unpredictable trend with the government failing to match the FDI inflow with the Gross Domestic Product. FDI flows to Kenya fell to Ksh 68,302 million ($455.34 million) in 2021 from Ksh 109,314 million ($728.76) in 2020, the lowest amount in the prior five years (UNCTAD, 2022).

For low-income nations, International Monetry Fund sets a benchmark debt-to-GDP ratio of 74%. Kenya's debt-to-GDP proportion, at 68.1%, is seen as sustainable due to the fact that it

is below the low-income country threshold. In contrast, the IMF's forecast for the debt-to-GDP ratio for the future shows a concerning trend, with the ratio expected to rise further and eventually surpass the 74% benchmark by 2024 (GoK, 2021).

Government spending keeps rising above receipts, necessitating debt financing to close the difference. Since revenue accounted for 18% of GDP on average, debt has been used to finance fiscal expansion (GoK, 2022). The goal of taking on such debt is to generate enough money through investments in the economy's productive sectors in order to pay it back. Nevertheless, in recent years, public debt has increased, rising from 59.5 per cent of GDP in 2015 to 67.3% of GDP in 2021 (Annual Public Debt Management Report, 2022). An increase in the amount spent on infrastructure projects that were entirely financed with debt started the trend. This begs question of , what is the impact of certain fiscal tools on foreign direct investment influx Kenya between 2002 and 2021 considering that other studies available have concentrated on specific elements of fiscal policy rather than the overall impact of these elements.

1.3. Objectives

1.3.1 General objective

The major this aim of research was examine the effect for selected Financial Policy instruments on Foreign Direct Investment inflow in Kenya from 2002 to 2021.

1.3.2 Specific objectives

i. To examine the effect of tax incentives on foreign investment in inflow in Kenya
ii. To the establish of effect recurrent expenditure on foreign direct enterprises inflow
iii. To effect the determine of external debt on foreign direct investment inflow.

iv. To establish the moderating effect of currenc.y exchange rate on the links between the selected fiscal policy instruments and foreign direct investment inflow

1.4 Research Hypotheses

The purpose of the study was to evaluate the following hypotheses.

$H0_1$: There is no statistically significant effect of between tax incentives and foreign direct investment Inflows in Kenya.

$H0_2$: No statistically significant effect of between recurrent expenditure and foreign direct investment in Kenya.

$H0_3$: There no statistically significant effect of between external debt and foreign direct investment in Kenya.

$H0_4$: There are no effect moderating of the rate of currency exchange on the link on the selected fiscal policy instruments with foreign direct investment inflow.

1.5 Scope of the study

Purpose of this research was to examine the effect of selected fiscal policy tools on foreign direct investment, Kenya. The scope of the content covered tax incentives, recurrent expenditure, and external debt on foreign direct investments in Kenya. It covered a twenty-year period from 2002 to 2021. The period to be studied was expansive, thus it provided precise results. It is the period by which the debt levels increased massively, the country experienced political changes, there was a change of government system to devolved, and the COVID-19 epidemic and transition caused obstacles in the ease of doing business, which affected foreign investment inflows.

1.6 Significance of the study

1.6.1 Policymakers

The study holds significantly implications for both policy formulation and economic development in Kenya. The findings provide policymakers with evidence-based insights into the effectiveness of taxation, recurrent expenditure, and the balance between external debt and FDI attraction. Understanding these links allows the government to make informed opinions on fiscal policies and attract more FDI inflows, encouraging long-term economic growth. The study provides a platform for future literature on the related topic under study.

1.6.2 Investors

This research provides valuable to both current and prospective shareholders and investors, enabling them to make informed decisions about the effects of corporate income tax expenditure, public debt, currency exchange rates on their returns and the recovery of their principal investments. Furthermore, the study provides well-informed choices about their investments and attractiveness of the companies in which they own stock.

1.6.3 Scholars

The study provides empirical information that will help scholars expand on the empirical data already available on the link betwixt specific fiscal policy instruments and influx of foreign investment direct. The finding study's and suggestions will serve also as a foundation for future reference materials for additional studies on foreign direct investment inflow. Future scholars will reference to this work and fill any gaps that may have emerged.

1.7 Limitations of the study

Study utilised uncilliary data gathered from diverse sources, thus there may have been variations. The researcher applied the triangulation method to compare data from various relevant sources to avoid discrepancies. In the event there are variations in data, the researcher had to use data from the National Kenya of Statistics Bureau since it is renowned source official data in Kenya to ensure data reliability. Data collection into a reporting tool

involves technical skill and takes time. Strong data systems made it simpler to solve this obstacle by providing quick accessibility to real-time information and appealingly present the findings.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In the chapter, a detail analysis on foreign direct investment is given. This chapter is organised into three sections, a theoretical review of the literature an empirical and a conceptual review. This Theoretical, literature, and empirical conceptual review aims to develop an understanding of effects of the selected fiscal policies on Foreign Direct investment inflow.

2.2 Theoretical Literature Review

An overview of the appropriate theories that explain the connection between foreign direct investments and fiscal policy is presented here. The theoretical reviews addressed are the investment in development path, Q theory of investment, Tax Competition theory, Crowding out effect theory, the theories of Sovereign Risk, Eclectic Paradigm, and Product Life Cycle.

2.2.1 Investment Development Path (IDP) Theory

Dunning (1988), established the Development Investment in Path theory a cornerstone for understanding FDI patterns across different stages of economic development. The theory posits that countries progress through stages of economic development; each characterized by varying levels of FDI reliance and specific investment motivations. In the context of fiscal policy, the IDP theory suggests that a country's fiscal measures, including taxation policies and public debt management, influence its attractiveness to foreign investors. For instance, During the early phases of development, tax incentives might be crucial in attracting FDI, while in later stages, a stable fiscal environment that ensures debt sustainability becomes

more vital. A critique of the IDP theory lies in its potential oversimplification of the dynamic interplay between fiscal policies and FDI motivations, often overlooking the intricate short-term effects.

2.2.2 Q Theory of Investment

Based on the Q paradigm concerning investments Tobin, 1969 which states that an organization's investment decisions are function of Q: the market worth of newly acquired additional investment items divided by their substitute cost. Research examines the effect of incentive tax measured as corporate income taxation expenditure on the allure of investment destinations (Bartlett & Partnoy, 2020). Marginal Q, the proportion of a unit of the capital market price to its market valuation, is the basis for all investment fluctuations. Tobin essentially says that shifts in the potential returns have an impact on investment choices (Tobin, 1978). Consequently, investors will raise their investment if they believe that the assets' value outweighs the replacement costs (Ishaq, Islam, & Ghouse, 2021). Tobin's Q is predicated on market price and replacement value ideas, which Grunfeld (1960) had previously suggested owners utilise to entice possible investors. Contrary to neoclassical investment theories, this theory bases investments on investors' assessments of the firm's growth prospects rather than According to Tobin's Q, capital investment increases when the value of capital surpasses its acquisition cost, which is an extension of Keynes' (1936) theory (Abel, 2008). A company's asset value is calculated using the The market value of shares in addition to the value book of all divided debt by the cost book of assets.. This is done using the market value of shares and debt (Tobin, 1969). Chen and Li (2018) claim that Tobin's Q can forecast investment in advantageous business environments that offer significant returns, as well as the effect assess of incentives related to and tax regulations firm on performance.

Countries now have a variety of tax structures to entice investors due to globalisation and competitiveness (Peter & Taylor, 2017; Andrei, Man & Moyen, 2019). Tobin's Q is criticised for being unreliable for accurate market valuation and long-term investment forecasts (Butt, Baig, & Seyyed, 2021). Its failure was noted by Gugler, Haxhimusa, Liebensteiner, and Schindler (2020) during the erratic, negative markets of the 1970s. However, according to recent research, Tobin's Q can accurately forecast total investment (Andrei, Mann, & Moyen, 2019). It was used by Gutiérrez and Philippon (2017) to explain why US manufacturing moved to China and other economies with more favourable tax regimes. As confirmed by Kogan et al. (2020), lower capital costs draw investment, underscoring the significance of Tobin's Q in investment-based asset pricing.

This theory is essential to comprehending how governments design tax policies, such as special economic zones and tax cuts, to draw in investment. By connecting this to the goal of evaluating how corporate income incentives tax affect foreign investments (FDI), Tobin's Q clarifies how tax breaks can enhance Kenya's appeal as an FDI destination. Such incentives can increase the number of foreign investors and create a climate that is more favourable for sustainable economic growth by raising value market the of investments in to relation their acquisition costs. The significance of assessing corporation tax laws in order to comprehend how they affect foreign global investment into Kenya is highlighted by this relationship.

2.2.2 Tax Competition Theory

The Tax Competition Theory, advocated by Hines (2000), focuses on how tax policies impact cross-border investment decisions. It suggests that countries engage in a competitive race to offer attractive tax regimes to multinational corporations, aiming to stimulate FDI inflows. In the of fiscal context policy, this theory highlights the significance of incentives related to tax as a tool to attract foreign investors. However, a critique of the theory pertains

to the potential erosion of tax revenue for host countries, raising questions about the sustainability of offering extensive tax incentives in the long run.

2.2.3 Crowding-Out Effect Theory

The theory of crowding-out effect by Keynes (1936) and Feldstein (1982), suggests that excessive government debt can absorb available capital in the financial markets, stifling private investment. This may, in turn, deter FDI by limiting the availability of resources for foreign investors. This theory establishes a linkage between high national debt levels and reduced FDI influx, highlighting the importance of effective debt management for attracting foreign investments. However, one of the shortcomings of this theory is that the crowding-out effect may not always apply, as it assumes a fixed money supply and ignores factors like international capital flows.

2.2.4 Debt Overhang Theory

As stated by Paul Krugman's theory of debt overhang (1988), a country experiences adverse economic consequences when its government accumulates high levels of external debt. Debt overhang occurs when the existing external debt becomes excessively large, leading to low foreign direct investment inflow and hindering the growth of the economy. It posits that overseas investments get deterred from investing in heavily indebted countries because they anticipate that a large amount of their income would go towards reducing the debt burden through high taxes. A significant amount of external debt burden is believed to create a disincentive for investment, both domestic and foreign, resulting in slower economic development. Krugman suggests that addressing and reducing the debt burden can improve the investment climate, attract capital, and minimize the risk of debt default, ultimately fostering economic growth. This study discovered that this idea was relevant in pointing that external debt impacts both overall economic growth and foreign direct investment. The study

sought to investigate how external debt affects FDI inflow in Kenya and thus used tenets of this theory in forecasting the outcome of the results.

2.3 Conceptual Review

Overvie of research-examined variables as they are embedded in the conceptual framework is provided in this section.

2.3.1 Foreign Direct Investment

Foreign Investment Direct (FDI) is of the most one important factors that affects a economic country's and growth. development UNCTAD (2021) defines foreign direct investment (FDI) as the foreign direct investor located economy in one has long-term interest and control, exercises over a business that is another located in economy. Furthermore, foreign globalect investment inflows entails the capital received by a foreigner with interest of investment who resides in the home country apart from its overseas head office based outside the county, or financial resources provided by an direct investor abroad to its overseas affiliate located in the declaring country (UNCTAD, 2022).

Foreign crossborder investment has a direct economic effect towards progress of a nation by creating job opportunities and improving skills through the transfer of contemporary technology.

2.3.2 Tax Incentives

A tax incentive is a government-provided reduction in taxes or other favorable tax treatment designed to encourage specific behaviors, activities, or investments that align with public policy goals. A research by Briyima et al. (2015) aimed to ascertain how tax incentives affected foreign investors' choices to make FDI. The results that tax revealed incentives had a

significantly inverse FDI effect on. Tax incentives were expressed as the annual tax revenue percentage of GDP. This study focused on corporate income tax expenditure as an investment incentive.

2.3.3 Recurrent Expenditure

Recurrent expenditure, also known as recurrent spending or operating expenses, refers to the ongoing, day-to-day costs that a business, government, or organization incurs to maintain its regular operations. Recurrent expenditure typically includes costs such as remuneration and earnings, interest acrual on state debt, pensions, and other charges employed in general maintenance and management operations. In Kenya, recurrent expenditure has been on the rise. Onifade, et al., (2020) examined how government expenditure impacted economic growth in Nigeria. Recurrent spending was calculated in their study as a proportion of GDP. Most studies have measured recurrent expenditure in its logarithmic form (Palea, et al., (2022); Amayo, 2016) in this research, recurrent expenditures were determined of the gross economical produce.

2.3.4 External Debt

The significance of debt is important for the economic progress of any given country and servicing this loan is vital for a country's foreign investment and economical growth, given that it constitutes the primary obligation settled using the total revenue collected within a specific timeframe.

To ascertain the overseas impact government debt on direct foreign investment influx into Keny, Kiungah (2018) carried out a study. It concluded that foreign direct investment intake into Kenya was inversely correlated with external borrowing. The foreign government borrowing, as expressed in natural logarithmic form on a quarterly basis, served as the

independent variable. The external debt was calculated in this study in percentage terms of the total GDP.

2.3.5 Exchange Rate

The relation between cross border investment and foreign exchange rate is reciprocal. A lower exchange rate in the host country makes it more appealing for foreign equity investors, as acquiring assets and covering investment expenses becomes more cost-effective (Madura & Fox, 2011). Conversely, FDI inflows can make the host nation's currency worth more relative to other currencies, driven by heightened demand for the domestic currency. A currency gains value when there is a greater demand for it. On the other hand, a currency loses value when there is less demand for it. The inclusion of currency value exchange rate volatility as a variable that acts as a moderator helps to capture the nuanced interactions between fiscal policy instruments, currency movements, and FDI inflows.

2.4 Empirical Literature Review

In the review empirical, the literature was organized according to the objectives of the specific research, are which to investigate the effects of tax incentives, external debt, and recurrent expenditure on foreign direct Investments (FDI). The reviewed studies are no more than five years old and are derived from various academic sources, including theses, journals, and conference proceedings.

2.4.1 Tax Incentives and Foreign Direct Investment

studies Several have examined the incentive relationship tax s and direct foreign investment. Siregar and Patunru (2021), investigated the effects of incentives tax direct on foreign investment inflows Indonesia. Research utilized ordinary least squares to analyse data from 22 countries between 1999 and 2018 order in to analyse of impact the tax incentive on direct

foreign investment, with other factors. The conclusion showed that tax breaks and foreign direct investment had the opposite effect.

Abille et al. (2020) researched the relation between Ghana's fiscal incentives and foreign direct investment. They period used data the for year 1975 to 2017 in their study utilising Distributed Autoregressive Lag (ARDL) bound method test. According to their findings, tax laws and foreign direct investment inflows have a favourable short-term association. For a country to draw in more cross boder investment, the experts advise Ghana to restructure its corporate tax system. It's important to note that whilst the current study looked at Kenya, the previous study only looked at Ghana.

Kyule(2018) aimed to find out the of tax impact incentives on the foregn direc investment flows in Kenya. The research analyzed data spaning a 2008 to 2017 period and employed a descriptive research design. Control variables included interest rates, economic growth, and inflation rates, measured every quarter by the Central Bank of Kenya. Multivariate analysis was employed to the interelation variables examine of the. The showed findings that inflation rates are a substantial determinant of FDI inflows, whereas individual tax incentives, interest rates, and economic development do not significantly affect FDI inflows. While this study concentrated on national statistics, this analysis was based on individual tax incentives.

Kariuki (2023), conducted a study to Analyse how Kenya's listed manufacturing companies attract investors in relation to corporate taxation. This study examined the connection between corporate tax and investor interest in Kenya's manufacturing industry using panel data sets of listed manufacturing firms for the years 2009 to 2021. Regression using panel data was employed in the study. According to the survey, listed manufacturing companies in Kenya had challenges in attracting investors due to corporate taxation. Tax incentives had

little impact on attracting investors when it came to the individual proxies for corporation taxation. This study covered a period of 13 years using selected manufacturing firms which is not comprehensive hence the study covered 20 years to map out the the impact of corporate tax expenditures as an incentive based on the country's FDI inflow data trend.

Linhartová (2018) examined the variables affecting direct foreign investment flow to the zech Republic, concentrating on years 1998–2015. Panel data from public financial reports were in the used study, and multivatiave regressor analysis was applied to data assess the. The results established that the amount of investment inflows was highly impacted by the corporate income tax rate. Since comparable incentives were offered throughout Europe, investment incentives had little the foreign impact on direct investments. The research came to the conclusion that enacting a progressive taxation or raising the corporation taxation rate would make the nation less appealing after 1% increase noting that a in the corporate rate tax caused some businesses to withdraw from the market. Additionally, other factors influencing FDI inflows included investment in research science and and national GDP, both of which exibited a positive impact, whereas Perceptions the Corruption Index negatively affected the country's attractiveness as an investment destination.

Olaleye, Memba and Riro, (2017) the investigated income impact of tax incentives on Nigerian listed companies' manufacturing performance. Although there were 176 manufacturing enterprises in total, 174 were the target population for this study, which used a descriptive research approach. The findings showed a significantly positive causal link inbetween foreign direct investment and lower corporation income taxation incentives. Reduced corporate income taxation incentives have a substantial and statistically positive relationship with foreign. direct investment. This relationship suggests that foreign investors are likely to increase their investments by utilising the fiscal incentives offered by the

government, which will support a sustainable business environment. This study will employ time series data for the county, while the previous study used descriptive research for a subset of industrial enterprises. The research was conducted in Nigeria while this research was focused on Kenya.

Abdioglu & Nida (2016) investigated how tax laws in OECD nations affected foreign direct investment. They divided the nations among those that have tax cut programmes and those that don't. They looked at the connections between those two nations via time-series analysis sets. Their findings demonstrated that imposition of tax has a big influence on international direct investment inflow. Furthermore, they discovered that different tax policies affected FDI differently in nations where there is a inverse relation between FDI and high tax rates. Although tax cuts are the primary focus of the research, additional tax incentives used by the government to sway investment inflows were also taken into consideration.

A research study was conducted by Briyima, et al., (2015) to the effect find out of tax incentives on investors'foreign decisions to FDI (Foreign Direct Investment). engage in study leveraged secondary data obtained the from CBN bulletin and World Bank Development Database that spanned over 32 years (1980 – 2011). Tax were measured incentives as tax revenue Yearly as a proportion of GDP. The revealed findings that incentives related to tax had a significantly impact on negative FDI. As a result, it was recommended that non-tax incentives be included so as to draw in more foreign direct investment. In contrast, this study focused on Corporate Income Tax as an Incentive implemented by the Kenyan government.

2.4.2 Recurrent Expenditure and FDI

The reserch by Onifade et, al, (2020) examined the effects spending of public on the growth economy of Nigeria. Specifically, it looked at the Ramifications of capital and recurrent expenditures for government fiscal expansion on sectors various the of economy. The study annual spanning time-series utilized data from 1981 to 2017 and applied Pesaran's ARDL approach to analyze the association public between indicators spending and GDP growth. Th showed e results a level between relationship public spending and growth in Nigeria economic. However, the discovered that study recurrent expenditures had a considerably detrimental influence on economic development, but th public e advantageous impacts of capital not investments significant were to overall investment and growth during economic the study period, therefore this analysis capitalised on the gap.

Aluthge et al. (2021) out carried research to analyze the of impact public for economic expenditure growth in Nigeria from 1970 to 2019. The research structural breaks and an ARDL model and found that both short and long-run recurrent spending had a inverse and insignificant impact on economic growth. The negative impact was mainly due to the government's interest payments on the debt. The study suggests that for recurrent spending to have a direct relation on GDP, it must prioritize human development. It establishes a connection between recurring spending and economic growth. In addition, the study sought to examine whether recurrent expenditure can increase FDI inflows in Kenya.

Oguso (2017) analysed impact the of recurrent expenditure public on the country’s growth in economic Kenya. The analysis relied on macroeconomic panel data segmented by sector from the financial year 1999/2000 to 2014/15 and covered seven different sectors. The analysis was done using a panel Distributed Autoregressive Lag model to assess impacts. Results implying increasing the percentage public recurrent expenditures relative to sectoral

GDP results in a negligible impact negative on sectoral short growth in the term, but a considerable negative impact long the in run. Furthermore, the results show that increasing the portion of sectoral development expenditure reveals a positive but marginal impact on growth in the short run. In the term long, this significant has a direct effect on industry growt.

Abonazel & Shalaby (2020). study Conducted a to examine the of net direct investment determinants foreign in 23 Middle Eastern and North countries African from the 1995 to 2017 using period Panel data analysis, both static and dynamic. The findings showed that macroeconomic drivers such as gdp growth raterate of inflation and public spending have considerable influence on net foreign investment direct flows.

2.4.3 External Debt and Foreign Direct Investment

the In study by Julie, (2018) on establishing the effect of debt on public foreign direct inflows investment in Kenya, was obtained data from secondary sources quarter a years period of for ten (January 2008–December every 2017). The research used a research descriptive methodology, and a multivariate model regression was employed to examine the the association context of variables the. Data analysed was using the Package Statistical for Social version Sciences,21. Vector Correction Error Model was employed findings and the indicated that, on their own, public debt rates,, exchange and inflation rates do not significantly determine inflows FDI in Kenya.

Kiunga (2018) conducted research to examine the of external impact government debt on foreign investment directly into Kenya. Explanatory variable was quarterly foreign government debt, expressed in natural logarithms. The control variables were the quarterly GDP growth rate and the quarterly CPI. Secondary data was collected quarterly during a ten-year period (January 2008–December 2017). The used study a error vector model correction

equation, a research descriptive approach, and a linear multiple regression to model analyse the variables' relationships. The study found that foreign government borrowing and economic development are not key drivers of FDI Kenya.

Wabwalaba (2017) conducted a study to determine the impact of government debt on FDI inflows into Kenya. The independent variable was public debt taken quaterly, expressed in natural log. The independent variables were CPI inflation rates, KSH/USD exchange rates, and GDP growth. The study's dependent variable was FDI inflows in Kenya, which were assessed quarterly. The findings that showed public debt, inflation rates, currency rates, and economic development are significant not predictors of inflows FDI Kenya. This was supported Ostadi and Ashja (2014), the study suggests that policymakers should limit the country's public debt levels, since they can impact FDI inflows.

Ngelechey (2015) study conducted a to analyse the between relationship government debt and foreign investment direct in Kenya. This study analysed data collected the from National Kenya Bureau Statistics of quarterly during the last 15 years (2000-2014) using SPSS 21.0. The study's results revealed a direct association between foreign and domestic debt. The findings propose that government policymakers pursue a foreign debt reform agenda in order to create a luctrative environment for more FDI Kenyan economy into the, since investor increased attractiveness in the local acts market as for FDI inflows a stimulant.

Muinga (2014). A was research conducted to ases the impact of extenal public debt on economic Kenyan growth. Researchers gathered a time series dataset from many sources, including the KNBS and World Development Indicators. The study applied the Dickey-Fulle augmented r Unit Root test to stationarity determine in the data set. The explanatory variables for economic growth included inflation, debt service payments, external public debt, interest

payments on external debt, capital, and labour. For data analysis, the study used the econometric technique known as Ordinary Least Squares (OLS). The research revealed that external debt burdens can discourage foreign investors due to worries about fiscal sustainability, and interest payments on external debt have a detrimental influence on Kenya's GDP growth. However, capital formation and the growing labour force participation had a favourable impact on economic growth. Furthermore, simulations demonstrated that any rise in foreign debt, while holding other factors constant, would negatively effect GDP, resulting in slower economic growth.

Numerous literary works have repeatedly proved that debt has an effect on levels of foreign investment direct (FDI). Given the worldwide economical downturn caused by causes such as increased inflation caused by rising global oil and food costs, several governments have resorted to increasing debt levels to supplement their revenue streams. Against this backdrop, the this aim of study is to explore the link between forex debt and FDI inflows at a period when Kenya's FDI inflows were dropping. The analysis used foreign debt measures relevant to Kenya, as specified by the national treasury, and linked them to FDI levels.

2.4.4 Currency Exchange Rate

A study was conducted by Khan (2021) to the impact analyse the of foreign rate exchange on the economy of Bangladesh using the time data series from the year 1990 up to 2020 to see how variables including inflation, direct foreign investment, nominal exchange rate and unexpected event shock influenced Bangladesh's economic development. The study employed Dickey-Fuller the Augmented and Root Phillips-Perron Tests Unit to find the existence of unit roots and guarantee that variables were all stationary. The method of Ordinary Squares Least was applied to the dependent relationship the determine between

variable explanatory and variables. The study found that the foreign exchange direct rate and foreign investment have a considerable impact on the GDP of the country. Inflation rate, foreign and the currency rate all had a favorable ipat.

Irungu (2020), conducted a study to examine how Kenya's FDI influx is influenced by the gross income growth rate, inflation rate, and exchan rate. The research analysed secondary World Bank annual data from the year 1988 to the year 2018. The percentage of FDI remittances to Kenya's GDP represented the dependent variable, FDI influx into Kenya. The data analysis found a moderately direct link between FDI inflows and various selected macroeconomic variables, such as inflation, economic growth rate, and rate, as currency exchange indicated by the computed correlation Pearson coefficients.

Waweru (2015) carried out a study to determine whether there is a link exchange rate between volatility and FDI in Kenya from 1993 to 2013. The exchange rate's volatility was determined leveraging the ARCH (Conditional Autoregressive Heteroskedasticity) and GARCH (Generalized Autoregressive Conditional Heteroskedasticity) models. The research further attempted to ascertain whether there is a nexus between volatility and the positive or negative influence it has on FDI. The found that study exchange fluctuation rate has a impact negative on direct foreign investment. Njuguna (2016) studied the link between rates and currency FDI in Kenya. The was study out on a conducted period beginning from January December 2006 to 2015, leveraging data secondary on remittances FDI and the of exchange spot rate rate collected monthly. A multivariable model was used regression to investigate how the influence factors FDI inflows. The data demonstrated a substantial positive link in relation to the exchange rate and FDI inflows into Kenya.

2.5 Summary and Research Gaps

In reviewing the empirical literature, it is clear that there are differing opinions and findings on the relationship between tax incentives, recurrent expenditure, external debt, and FDI. While some studies suggest positive correlations, others highlight the importance of contextual factors and sector-specific considerations. Therefore, the research aimed to contribute to this field of knowledge by critically evaluating the existing literature, addressing methodological flaws, and identifying gaps that informed the study's focus and methodology. Specifically, data was analyzed from a sample population of countries, considering the nuances of each objective and examining the emerging research gaps in the context of the problem being addressed.

Table 2.1 Summarization Table of the Empirical Literature

Author and Year	Title	Model employed	Conclusions	Research gaps
Sirenga & Pantura (2019)	The effectiveness of Tax incentives on FDI Inflow in Indonesia	Gravity Model	Inverse Relationship between Tax Incentives and FDI	The study focused on Indonesia while this focused on Kenya

Kariuki (2023)	conducted a study to assess the Effect of corporate taxation on investor attraction of listed manufacturing firms in Kenya.	The study used a panel data regression	The study revealed that corporate taxation held a significant effect on investor attraction of listed manufacturing companies in Kenya.	This study covered a period of 13 years using selected manufacturing firms which is not comprehensive hence the study covered 20 years to map out the effect of the corporate income tax expenditure as an incentive focusing on the country's FDI inflow data trend.
Abille et al. (2020)	correlation between fiscal incentives and foreign direct investment (FDI) in Ghana	Autoregressive Distributed Lag (ARDL) bounds test technique	Recurrent expenditure negatively impacts economic growth	The study only focused on Ghana, while the present study examined the situation in Kenya

Linhartová (2018)	Factors Influencing The Foreign Direct Investment Inflow In The Czech Republic	employed multiple regression analyses for evaluation	The study concluded that introducing a progressive tax system, or increasing the company tax rate would reduce the attractiveness of the country	This study used the corporate tax rate as the variable to measure tax policy. The statistical significance of CIT as an explanatory variable is not conclusive. To bridge on this gap tax incentives measured as corporate income tax expenditure variable as a type of tax incentive were utilized in our study.
Olaleye, Riro, and Memba (2017)	Effects of income tax incentives on	The study concluded that there is a	The study used descriptive research for	This study used time series data for the county

	the performance of listed manufacturing firms in Nigeria.	significant and statistically beneficial relationship between reduced tax on corporate income incentives and foreign direct investments	selected manufacturing firms in Nigeria.	conducted in Kenya.
Kyule(2018)	determine the effect of tax incentives on foreign direct investment inflows in Kenya	Vector Error Correction Model	Individually tax incentives, interest rates, and economic growth are not significant determiners of FDI inflows in Kenya	The variables differed from the current study Focus on national rather than individual Tax incentive
Briyima, et al., (2015)	impact of tax incentives on foreign investors'	Vector autoregressive (VAR)	tax incentives had a significantly negative effect	Tax incentives were measured as annual tax revenue as a ratio

	decisions to engage in FDI		on FDI	to GDP while this study focused on Corporate income tax Expenditure as an investment incentive
Onifade et al. (2020)	The effects of public spending on the growth of the Economy in Nigeria	Pesaran's ARDL approach	There was a steady correlation between public spending and the growth of the economy in Nigeria.	The research focused on the domestic debt variable on investment and ignored external debt
Aluthge, et al, (2021)	Effect of government spending on economic development in Nigeria during the period from 1970 to 2019.	Structural breaks and an ARDL model	Short and long-term recurrent expenditures had an inverse and no significant impact on economic growth.	The results were insignificant hence this study aimed to investigate whether recurrent expenditure can enhance FDI inflow in Kenya.

Abonazel & Shalaby (2020).	Determinants of net FDI in the Middle East and North Africa (MENA) area.	static and dynamic panel data analysis.	Public expenditure has significant effects on net foreign investment (FDI) inflows.	This research focused on a combined public expenditure while this study will focus on the relationship between recurring expenditure and FDI Inflow
Oguso (2017).	Examined the impact of public recurrent expenditure on economic growth in Kenya	The analysis was conducted using a panel ARDL	persistent rise in sectoral public recurrent costs is growth retarding	This study used panel ARDL model while this study employed time series data.
Julie, (2018)	The effect of public debt on FDI inflows in Kenya	Vector Error Correction Model	The results revealed that individually, state debt is not a significant	The findings do not indicate how External loan affects FDI Inflows in Kenya

			predictor of FDI inflows in Kenya.	
Kiungah (2018)	To study the effect of external government borrowing on foreign investment direct inflows in Knya.	vector error correction model	External government borrowing and economic growth do not significantly influence FDI inflows in Kenya.	There is no significant relationship between foreign debt and FDI
Muinga (2014)	How external public debt affects economic growth in Kenya	augmented Dickey-Fuller Unit Root test	An inverse correlation between external debt and GDP.	This study focused on the effects of External Debt on Gross Domestic Product while this study will focused on its effect on FDI
Khan (2021)	Impact of the exchange rate on the economy	The Augmented ADF-test and	Exchange ratio fluctuation has a positively	Research focused on Bangladesh while this study

	in Bangladesh	PP-test	significant relationship with economic growth	focused on Kenya
Waweru (2015)	The relationship between currency rate volatility and foreign direct investment in Kenya.	ARCH and GARCH model	The volatility of the exchange rate harms Foreign Direct Investment.	Data covered a period from 1993-2013 while this used data from 2002-2021.

Source: (Author, 2023**)**

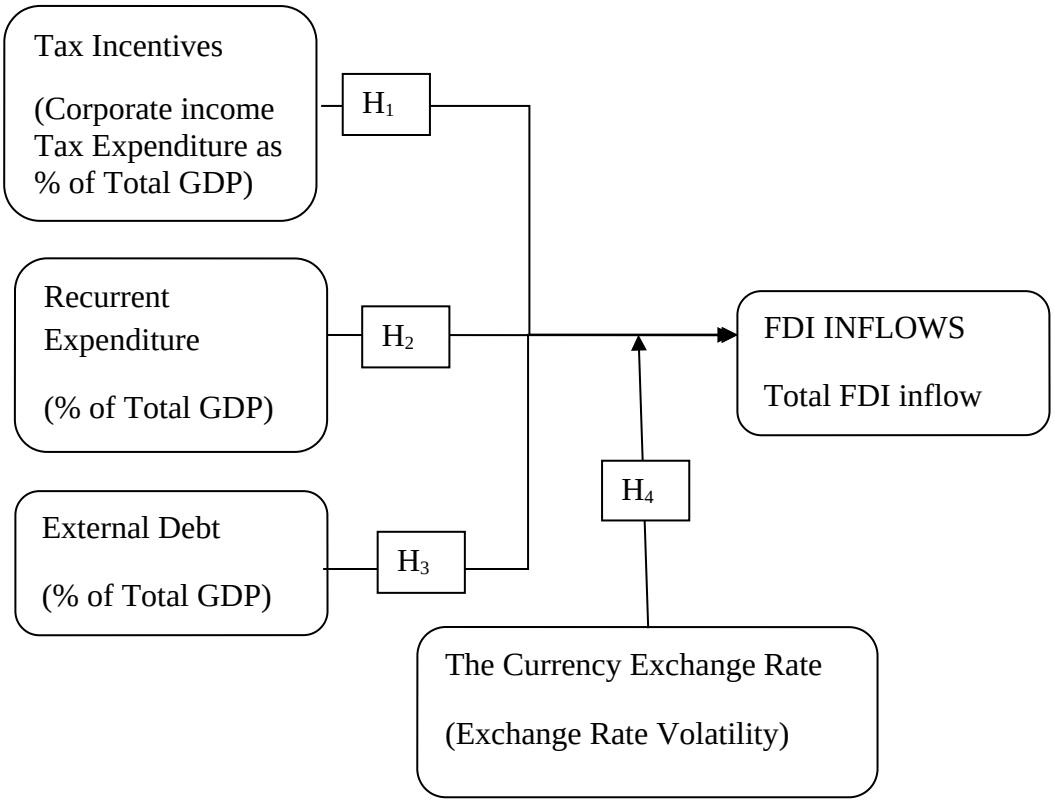
2.4 Conceptual Framework

The conceptual research framework explained the relation between tax incentives to FDI inflow, recurrent expenditure to FDI inflow, external debt to FDI Inflow as the explanatory variables, and FDI inflow as the dependent variable. The intervening variable is currency exchange rate. The study evaluated the independent effect the of variables on variable output.

Figure 2.1 Showing the Conceptual Framework

Independent Variables

(Fiscal Policy Instruments) **Dependent Variable**



Source: Researcher (2024)

Explain the conceptual framework, how the variables are likely to affect each other

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter outlined the study approaches used to objectively effect determine the of the selected policy fiscal instruments Direct on Foreign Investment in Kenya. It also illustrates the area study, design research collection, data, analysis data, and presentation.

3.2 Study Area

The research study was done in Kenya since Vision 2030 identifies industrialization as one of the key sectors to spur the country into middle-income status. Kenya has had a persistent Foreign Investment Direct Shortfall leading to prolonged cycles of the balance of payment deficits (Ogero, 2023). Kenya one of is the African East Countries that is located between latitudes 5^0N and 4.5^oS and longitudes 34^0E and 42^0E and an of covers area …….with a population of ……(KNBS, 2019). The climate is mainly ……which facours agriculture as the main source of economic activities (Citation (s). RELATE AGRICULTURE TO FDI AND TO BALANCE OF PAYMENT DEFICIT HERE

3.3 Research Design

Research as framework a design is defined that outlines a clear copy of the research methods employed. Descriptive, Correlation and study designs causal were adopted the for study. Correlation quantified the degree and direction of the correlation between FDI and fiscal policy instruments, descriptive research design employed time series data to explain the trends in FDI and fiscal policy tools overtime while causal design was used to the

establish effect policy selected of the fiscal instruments on FDI in Kenya over the years from 2002 to 2021. Creswell, 2017 asserts that in selecting the research design, it is important to take into consideration the use of statistical data to establish the nexus in within the variables devoid of manipulating the information data.

Quantitative research allowed for the testing of theories, ascertaining facts, showing the connection between variables, and forecasting results. Data was converted to numerical codes that represented the measurement of the variables study (Mugenda & Mugenda, 2003).

3.4 Data Collection

Data were acquired based on secondary sources for a period of twenty years (from 2002 to 2021) and later analyzed using E-views. The data for the trend in FDI inflow was derived from World Investment Reports, World Bank and IMF. External debt data Tax incentives and recurrent expenditure were derived from Budget and Review Outlook Papers, Government Tax Expenditure reports, the Kenya Authority Revenue (KRA), the National Statistics Bureau of (KNBS), and Bank the Central of Kenya (CBK).

3.5 Data Analysis and Presentation

The E-Views Version 12 was applied in the examination. Data analysis involved tabulation of means and derivation of trend analysis by us of graphs, analysis correlational was done to direction determine the intensity and independent variable (increase in FDI inflow) and the independent variables (Tax Incentives, Recurrent expenditure, and External Debt. Later inferential statistics was computed to test the study hypotheses. In addition, the multivariate linear regression analysis was conducted to demonstrate the impact of tax incentives, recurrent expenditures, and external debt on FDI in Kenya. The presented were findings in tables.

3.6.1 Description and Measurement of Variables

Table 3.1 Outlined variables study and their measurement techniques, and the expectd sign.

Table 3.1 Description of Study Variables

Variable		Description	Measurement	Predicted sign
Y	FDI Inflow	An increment in the net	Yearly growth rates	+/-
$\mathbf{X_1}$	Tax Incentive	Deduction, exclusion, or exemption from tax duty.	CIT % of GDP	+/-
$\mathbf{X_2}$	Recurrent Expenditure	Overall operational expenses	% of GDP	+/-
$\mathbf{X_3}$	External debt	foreign debt	% of GDP	+/-
$\mathbf{X_4}$	Exchange rate	Proportion of changing a country's Exchange rate The country into another currency	Exchange rate volatility	+/-

3.6.2 Economic Specifications Model

The two data was analysed in steps.

Step 1: The researcher performed a multipl regression to evaluate the hypothesized dependent relation between the variable (FDI inflow) and the variables independent (tax recurrent incentives, expenditure, and external debt).

The subsequent was model applied.

$Y_t = \beta_0 + \beta_1 X_{1t} + \beta_2 X_{2t} + \beta_3 X_{3t} + \mu$

Where; Y_t = growth in FDI Inflow during the period t,

β_0=Constant.

β_1.....β_3= The slopes represents how much the growth of FDI Inflow varies as the regressors changes by one unit.

X_{1t}= Tax Incentives (% of total GDP)

X_{2t}= recurrent expenditure (% of total GDP)

X_{3t}=External Debt (% of total GDP)

The determination of coefficient (R^2) was used to show the variation in $\mathbf{Y_t}$ (Trend in the FDI Inflow over time) the variation explained by in Tax Incentives($\mathbf{X_{1t}}$), expenditure Recurrent ($\mathbf{X_{2t}}$), and External Debt ($\mathbf{X_{3t}}$) over time.

Step 2: The researcher performed hierarchical regression approach to assess the effect moderating of rate exchange on the effect of Tax Incentives, Recurrent, and External Debt on the growth of FDI inflow. The expenditure following was model used;

$$\mathbf{Y_t = \beta_0 + \beta_1 X_{1t} M_t + \beta_2 X_{2t} M_t + \beta_3 X_{3t} M_t + \mu}$$

Wheire; $\mathbf{Y_t}$= FDI Inflow during the period t.

$\boldsymbol{\beta_0}$=constants.

$\boldsymbol{\beta_1 X_{1t} M_t + \beta_2 X_{2t} M_t + \beta_3 X_{3t} M_t =}$ interaction terms.

The study compared the values of regression models studying the effect with and without the moderating variable to identify any significant differences in R^2. An F-test was used to determine if variation the in R^2 is the significant. If is significant change, it indicates that the

exchange currency rate influences the model regression. If the R^2 statistically change was significant not, it would imply that the Currency Rate Exchange makes no significant contribution to the regression model and thus has no influence on the of effect Incentives Tax, Recurrent Expenditure, and External Debt on Foreign Investment Direct Inflow in Kenya.

The results were presented using statistical and figures tables.

3.7 Diagnostic Tests

The researcher did the subsequent diagnostic tests: unit heteroscedasticity test, , autocorrelation, root multicollinearity, and norrmality test.

3.7.1. Unit Root Test

The researcher conducted a unit test root at different levels to assess the of the stationarity data. tests Unit root are used to assess in a time stationarity series (Politano et al., 2018). A time aseries is considered be stationary if a temporal does shift not modify the form of the roots distribution; unit are a of nonstationarity source. As a result, to evaluate if the time series variables were non-stationary or had a unit root, the researcher applied the unit root test. Serial correlation can be an issue eries with time sdata therefore employed, the Dickey-Fuller (ADF) Augmented test was to stationarity assess (Coelho et. al, 2023). The ADF larger, models more complex. The disadvantage of this is the error comparatively Type high I rate (handles Kumar, 2019). A unit occurs in root a time with the series value =1 alpha, as seen in the subsequent equation.

$$Y_t=\alpha Y_{t-1}+\beta X_e+\epsilon$$

Where Yt represents the time time value series at t and Xe is the explanatory series variable time at the time t. Therefore, root presence a unity of implies nonstationarity of in the time

series. Additionally roots, the number of unity shows the number of differentiation operations make required to the stationary series (Nasir & Morgan,2023).

The null hypothesis of test is there is unit root in the data. If the probability value is than less 0.05, then there is evidence to suggest that there unit is no root. However, if a unit root is present, it can be corrected by differencing the data (Neifar & Gharbi, 2023).

3.7.3 Heteroscedasticity

Heteroscedasticity occurs when the variance of the independent variable population varies with of the population the explained variance variable (Breusch and Pagan, 1979). The study used test the Breusch- test to Pagan for heteroscedasticity. A p-value of less 0.05 implies the existence of the heteroscedasticity in mode regression.

3.7.3 Autocorrelation

The problem of emerges autocorrelation whenever residuals the from observations different are correlated periods or (i ε) correlated and observations (j ε) are, i.e. (≠ 0) and or for all I j, hence aiming to identify a pattern within the time series(Lusompa, 2023). This test was Carried out employing the Durbin-Watson statistic Breusch-Godfrey and the test. The Durbin-Watson (DW) test is a statistical autocorrelation method for identifying in the residuals of a linear regresor model (Singh, & Singh, (2022). The test ranges from 0 to 4, with the null in statistic hypothesis that residuals there is no asserting autocorrelation the. A statistic near 2 suggests no autocorrelation, while a value below 2 indicates positive autocorrelation and a value 2 suggests above negative autocorrelation (Balaji & Saravanabavan, 2021). The Breusch-Godfrey test a technique for detecting autocorrelation in residuals of a linear regression model. It helped to detect autocorrelation at different delays. Initially, the regression was performed, and residuals were recorded for all time point.

The residual term was then regressed against the original set of independent variables as well as one or more additional variables that represent lagged residuals. Hypothesis tests were then carried out for each coefficient to evaluate whether they significantly differ from zero, assuming a chi-square critical distribution with p−k−1 freedom. The given degrees of was compared to the F-statistic rejected value. If the study the null hypothesis for a time lag, the study concluded that there was a serial correlation for that time.

3.7.4 Multicollinearity

A phenomenon where there is inter-correlation explanatory among the variables (Mohammadi, 2022). Multicollinearity is present when variables independent are extremely the linearly related in a multiple regression model (Shrestha, 2020). Variance Inflating Factor (VIF) was applied to multicollinearity check for. Accordingly, the value of VIF should be less than 10 to show that no multicollinearity exists (Shrestha, 2020).

3.7.5 Normality test

The error component has a of zero mean, a variance constant of μ (0,1), and follows the standard linear regression model assumptions (Grégoire, 2016). The normality test determined whether all data exhibited a normal distribution pattern. Th test e Jarque-Berra was used to test normality. The hypothesis null had a zero skewness and zero excess kurtosis. If the Jarque-Berra probability was above 0.05, all data was considered to have a normal distribution (Bouri & Jalkh, 2023).

3.7.6 Model Stability Test

To assess the regression model's stability, the researchers utilised a CUSUM test. According to Zeileis (2004), the test's decision criterion was that if all in the model variables fell below the 5% limit, the was stable model.

3.8 Hypothesis Testing

Arendtm Matthes (2017) hypothesis described testing as a statistical procedure in which researchers evaluate statements about population parameters. This method was employed to infer the hypothesis outcome of a on survey based data from larger population. In hypothesis testing, researchers aim to either support or reject a null hypothesis through statistical analysis. The results inform the researcher about the validity of the initial hypothes. If the hypothesis is not supported, the researcher formulates a hypothesis to be new tested and replicates experiment until evidence supports a definitive conclusion.

The were F-test and conducted at a 95% level confidence to evaluate statistical significance. was The F-statistic used to determine significance the statistical of the regression equation, t-test concurrently, the t-statistic to determine was used the statistical study implication of coefficients.

3.9 Ethical Consideration

When utilizing secondary data in this research, the researcher addressed several considerations to ethical ensure the and integrity credibility of the study. Firstly, researcher ensured that all information remained confidential and privacy of the organizations providing the data by obtaining proper permissions from them. Additionally, the researcher was transparent about the origins of the data, accurately citing the sources of the data and

acknowledging any biases inherent in the secondary data. The researcher used the data responsibly, applying it in a manner consistent with the original intent of the data collection and avoiding any misrepresentation or misuse. By adhering to these ethical guidelines, the researcher maintained the trustworthiness and ethical standards of paper.

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1 Introduction

This chapter delved into the descriptive statistical analyses, focusing on evaluating the association between Foreign Direct Inflow and the fiscal policy instruments under study which are tax Incentives, recurrent expenditure, and external debt with the Currency exchange rate as the intervening variable. It commenced with an overview of the initial descriptive statistical findings, proceeded to correlation analysis, and then presented the outcomes of complex time series analysis.

4.2 Descriptive Summary

The study used yearly data sources including the World Bank, UNCTAD, IMF, CBK, KRA, and KNBS to conduct statistical measurements like mean, deviation standard, least, maxima, skewneses, and kurtosiss. According Anderson, Sweeney, & Williams (2020), descriptive statistics should be based on raw data rather than transformed data during analysis. Mean is a measure that represents of central the average given tendency value of a variable. Standard dispersion deviation measure is a of that explains how far the observations are from the sample average. Kurtosis and skewness are measures of normality. The mean is a statistical measure of central tendency that denotes the value average of a variable. Standard deviation indicates the dispersion of observations from the sample average. Kurtosis and skewness, on the other hand, are metrics used to assess the normality of data distributions (Johnson, 2010). When a dataset has a kurtosis value of 3, indicating a normal distribution, it is termed a Mesokurtic. Conversely, if the curve is peaked showing positive kurtosis, it is termed as Leptokurtic, suggesting it has higher values compared to the mean. Likewise, a flattened curve showing negative kurtosis is called Platykurtic, indicating lower values than the mean.

Skewness is asymmetry a of in a dataset measure. A distribution is considered to have normal skewness when it's symmetrical around the mean, with a skewness value of 0. In contrast, positive skewness indicates a long right tail, suggesting higher values compared to the mean. Positive skewness typically starts from a value greater than 0.5 (Smith, 2020). On the other hand, negative skewness means a long-left tail, indicating lower values compared to the mean, and negative skewness generally starts from -0.5. Additionally, the maximum and minimum values represent the highest and lowest values within each variable.

Table 4.1: Descriptive Statistics

	FDI	TAX	REX	EXT	CER
Mean	534.0805	0.145500	8.842000	28.03000	87.22500
Median	466.1750	0.150000	8.775000	27.60000	85.32500
Maximum	1450.000	0.240000	15.35000	39.20000	109.6400
Minimum	21.21000	0.050000	4.420000	18.80000	67.32000
Std. Dev.	484.4778	0.048610	3.204058	6.232943	13.37047
Skewness	0.651074	-0.183866	0.330393	0.219528	0.225556
Kurtosis	2.172018	2.625049	2.054488	1.871896	1.687089
Jarque-Bera	1.984285	0.229845	1.108859	1.221158	1.606030
Probability	0.370781	0.891435	0.574400	0.543036	0.447976
Sum	10681.61	2.910000	176.8400	560.6000	1744.500
Sum Sq. Dev.	4459656.	0.044895	195.0537	738.1420	3396.619
Observations	20	20	20	20	20

Source: Researcher computation based on E Views 10 Use APA format of table

Table 4.1 provided measures of central tendencies of both FDI inflows and fiscal policy instruments. FDI Inflow had a growth mean of 534.0805, a deviation standard of 484.4778, a least value of 21.21, and a peak value of 1450. FDI inflow has a skewness of 0.651074, indicating a moderately positive skew. This means that the dataset was somewhat skewed to the right, with a tail on the higher end of the values, suggesting that there were higher values compared to the mean. However, the skewness value was still relatively close to 0, indicating that the skewness was not extremely pronounced but was noticeable.

Also, FDI Inflow had a kurtosis of 2.172018 < 3 suggesting a distribution that was slightly more peaked than a normal distribution (Mesokurtic). This means that the dataset had a slightly higher proportion of extreme values compared to a normal distribution, resulting in a peakier curve. However, since the kurtosis value was relatively close to 3 (the kurtosis value for a normal distribution), and the Jarque-Berra probability of 1.984285 > 0.05 the deviation from normality was not very pronounced. (normal/mesokurtic), meaning it is platykurtic. Therefore, the interpretation of the findings suggests that the distribution of FDI inflow (as a of GDP percentage) exhibits a slight peakiness or concentration around the mean value, with a relatively balanced distribution of extreme values compared to a normal distribution. This means the distribution is not perfectly normal but is close to it, indicating a moderate degree of variability in FDI inflows relative to GDP.

TAX had a average of 0.1455%, a standard dispersion of 0.048610%, lower value of 0.240%, and a peak value of 0.050%. Besides, TAX had a skewnes of -0.183866 indicating a slight negative skew in the dataset. This means that the distribution was slightly to the skewed left, with on the lower a tail end of the values, suggesting that there are least values compared to the mean. However, the skewnes value of -0.183866 was relatively close to 0 and has the probability value from Jarque the -Bera test of 0.891435>0.05 indicating that skewness was not very pronounced and the distribution was not highly skewed in either direction. Tax Incentives (TAX) also had a kurtosis value of 2.625049<3 showing a slightly flatter distribution than normal (Platykurtic). However, the deviation from normality was not very significant.

REX had a average of 8.84200 %, a standard dispersion of 3.204058%, a low value of 4.4200%, and a highest value of 15.35000 %. Furthermore, REX had a skewness of 0.330393 < 0.5, A skewness of 0.33 indicates a moderate positive skew, leaning towards higher values

with more frequency above the mean. Besides, REX kurtosis had a of 2.054488 < 3 , implying it is platkurtic. The Jarque-Berra probability of 1.108859>0.05 also gave a normal distribution result.

External Debt (EXT) had average of 28.030, a deviation standard of 6.232943, a lower value of 18.800, and a upper value of 39.200. Also, EXT had a skewness of 0.219528<0.5, this implied that while there was a slight inclination towards higher values, the distribution remained relatively balanced with no significant skewness. Additionally, EXT had a kurtosis of 1.871896 < 3 and the probability value from the Jarque-Bera test of 0.543036 (normally distributed). External Debt (EXT) as a GDP percentage of shows a stable relatively distribution around the mean with moderate variability. This analysis helps in understanding the relative burden of external debt on a country's economy and its distribution across different GDP levels.

Currency Exchange Rate (CER) had a mean of Ksh 87.2250, a standard deviation of Ksh 13.37047, a minimal value of Ksh 67.320, and a maximal value of Ksh 109.6400. Furthermore, CER had a skewness of 0.22556 < 0.5, indicating a mild positive skew in the data distribution. This suggested a slight preference for higher values. Besides, CER had of a kurtosis 1.6870893 and a Bera test Jarque- value probability of 0.447976>0.05 indicating that the data is distributed normally.

The study concluded from the measures of central tendency that FDI, tax incentives, recurrent expenditure, public expenditure and currency exchange rate were normally distributed.

4.3 Trend Analysis

Trend was for analysis conducted FDI inflows; Tax incentives, recurrent expenditure, External debt and Currency Exchange rate. The trend analysis was done to reveal if there were some shocks experienced overtime. The trend the lines in subsequent presented were sections.

4.3.1 Foreign Direct Investment Inflows

Figure 4.1 showed significant foreign direct investment Inflow fluctuations over the years. It reached its peak in 2011 and 2017.

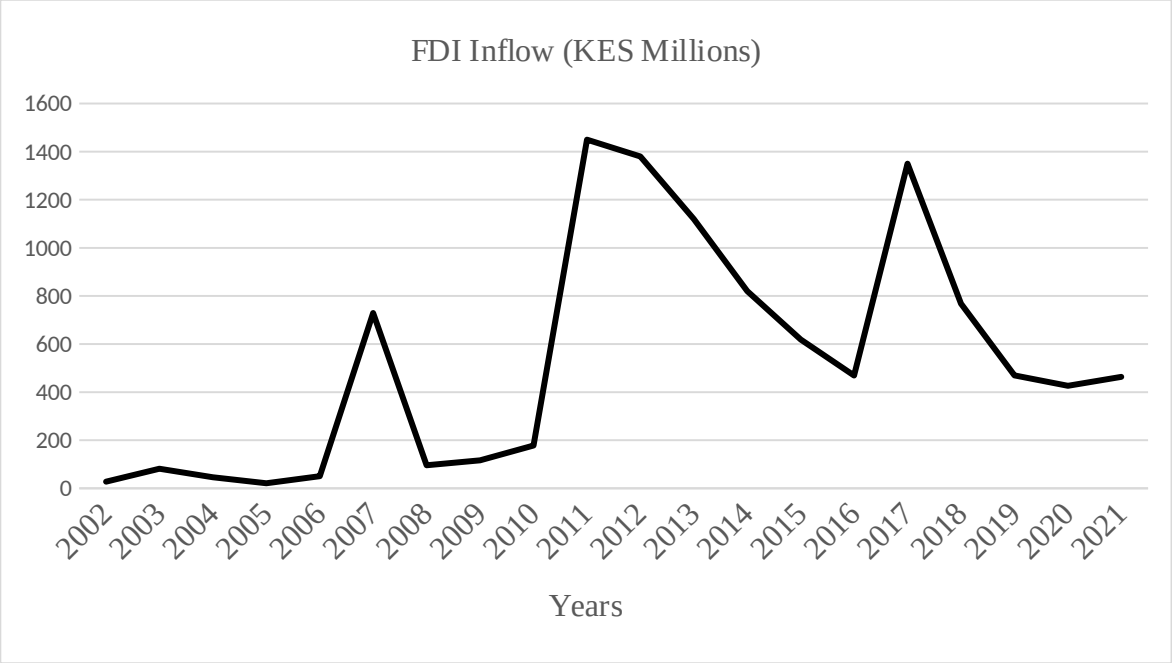


Figure 4.1: Annual FDI Inflows

This sharp increase in 2007 FDI inflow can be attributed to the positive economic environment in Kenya before the global financial crisis. The period leading up to 2007 saw significant reforms in Kenya's economic policies, increased political stability, and efforts to improve the business making climate,it an foreign attractive destination for investors.

(Mwega, 2010). The global crisis financial of 2007-2008 had a impact significant on FDI inflows worldwide, including Kenya. The crisis led to reduced investment flows as foreign investors became more risk-averse Additionally, the post-election violence in Kenya in 2007-2008 created political instability, further economic discouraging foreign investment (Ndolo, 2017). The peak in 2011 can be attributed to the significant growth and improved investment climate . enactment of the new Constitution in 2010, which promised greater political stability and reforms, likely boosted investor confidence (World Bank Group, 2016) Additionally, the discovery of oil in Turkana in 2012 may have started attracting substantial interest from foreign investors. In 2017, large-scale infrastructure projects like the Standard Gauge Railway boosted FDI (Mwalagho, 2020).

4.3.2 Tax Incentives

The sought determine study to tax the movement of incentives in over Kenya period under study, the line graph shows a general increase, with some fluctuations. Higher tax incentives could attract more FDI the investors.tax by reducing burden on foreign For instance, the

peaks in FDI inflow in 2011 and 2017 coincide with higher tax incentives.

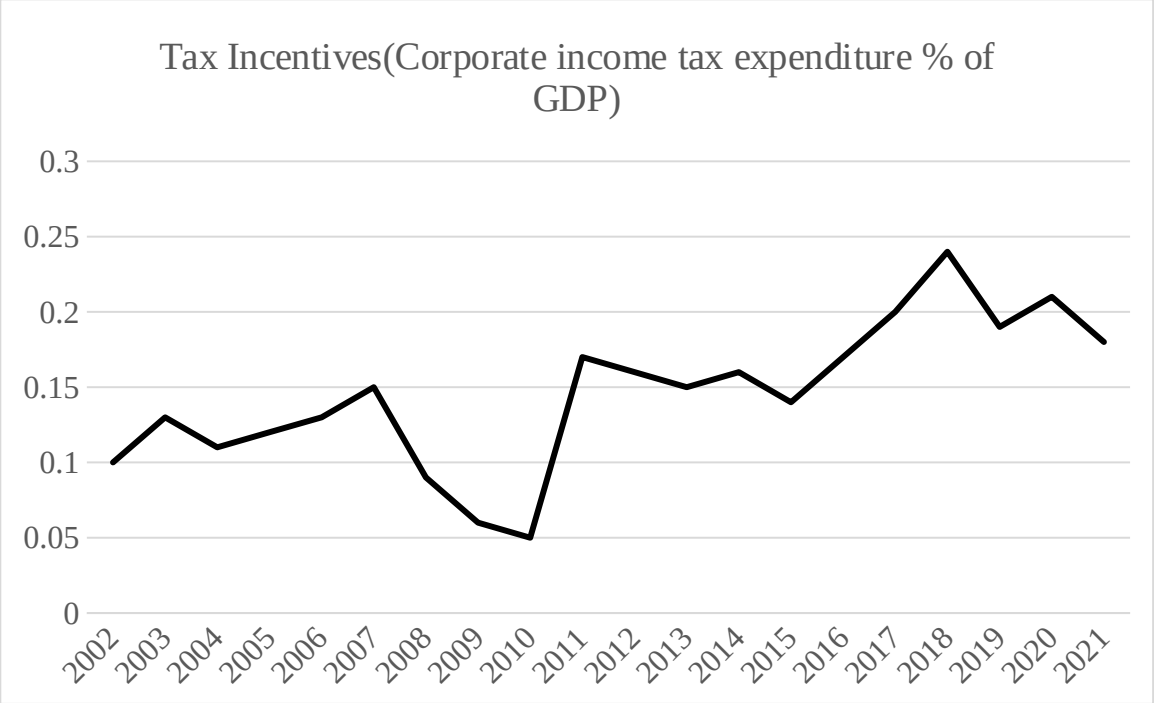


Figure 4.2: Annual Tax Incentives

The increases in tax incentives in 2003, 2007, 2011, 2017 and 2018 reflect the attract government's to foreign efforts direct investment (FDI) through favorable tax policies, particularly CreatioRecovery in Vision line with the for Wealth and Economic Strategy Employment n, 2030 (Njiru, et al, 2020).The decreases in 2008, 2009, and 2010 were influenced by the global financial crisis and domestic economic instability following post-election violence, which led to a more cautious fiscal approach. The slight reduction in 2015 was part of fiscal consolidation efforts to manage the budget deficit. Increases in 2019 and 2020 aimed to stimulate economic activity amid global economic slowdown, while the slight decrease in 2021 reflected a balance between providing tax incentives and ensuring fiscal sustainability in the post-pandemic recovery phase (World Bank, 2021).

4.3.3 Recurrent Expenditure

Th paper aimed to discern the recurrent movement trend in of expenditure measured in luctuatingKenya over the study s suggests period. The trend line sharp is as shown in Figure 4.4. Figure 4.4 indicated recurrent expenditure have been f over the years. A increase in recurrent expenditure in 2008 coincides with a lower FDI inflow. Thi that higher government spending might not directly correlate with higher FDI.

Figure 4.3: Annual Recurrent Expenditure

The peak in 2006 (13.40%) was due to increased government spending on public services and infrastructure as part of economic growth strategies. The sharp rise in 2008 (15.35%) resulted from additional spending to address the impacts of post-election violence and its economic repercussions. The drastic decreases in 2009 (4.42%) and 2010 (4.80%) were caused by the global fiscal crisis, which led to reduced government revenues and forced cuts in spending. In 2011 (4.97%), lower expenditure could have been due to a focus on economic stabilization and debt management.

4.3.4 External Debt

The study the trend sought to establish movement in the of external debt public measured as a percentage of GDP in Kenya over the study period shown in. is Figure 4.4 The trend line. Figure 4.4 indicated that external public debt has been gradually growing progressively annually.

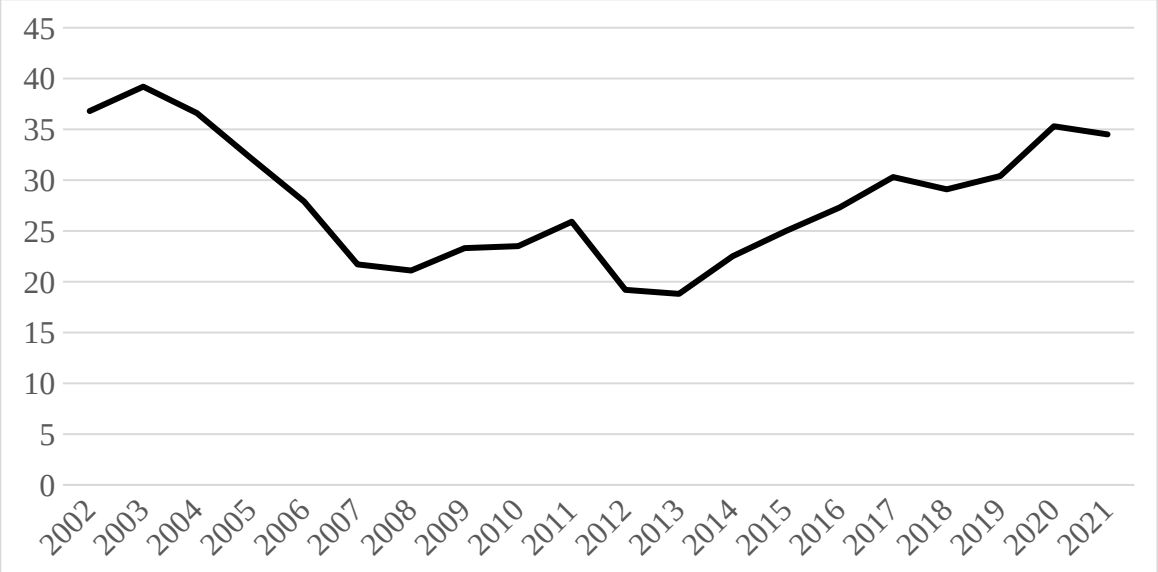


Figure 4.4: Annual External Debt

The decline in external debt from 36.8% in 2002 to 21.1% in 2008 which could have been driven by debt relief initiatives and improved fiscal management, particularly the Heavily Indebted Countries (HPC) Initiative, which could reduce Kenya's debt burden (World Bank, 2008). However, external debt began rising again in 2009 (23.3%) and 2010 (23.5%) which could have been as a result of increased borrowing to counteract the global financial crisis's economic impact and fund infrastructure projects. The debt ratio continued to increase in subsequent years, peaking at 30.4% in 2019 as Kenya undertook significant infrastructure projects under Vision 2030 and increased borrowing to finance these investments (Government of Kenya, 2017). The rise in external debt in 2020 (35.3%) and 2021 (34.5%)

reflects increased borrowing to manage the economic fallout from the COVID-19 pandemic and support recovery efforts (IMF, 2020; World Bank, 2021)

4.3.5 Currency Exchange Rate

The study trend sought to establish the movement in the of currency exchange rate in Kenya over the study been period. The trend is Figure 4.6 Figure 4.6 indicated however that currency exchange rates have upward line fluctuating over the shown in years. On average, , currency exchange rates have been on an trend.

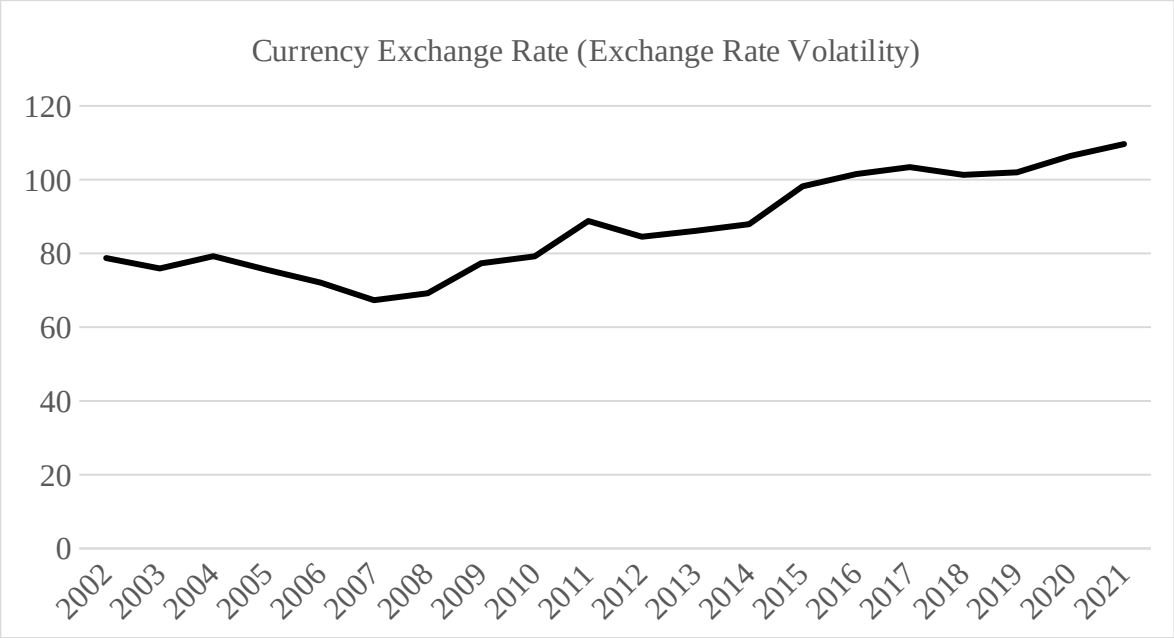


Figure 4.5: Annual Currency Exchange Rate

The fluctuations in Kenya's currency exchange rate from 2002 to 2021 reveal insights into the country's economic stability and monetary policy. The exchange rate, measured as volatility, initially decreased from 78.73 in 2002 to 67.32 in 2007, reflecting a period of relative stability and improved economic conditions. However, this trend reversed with volatility rising to 88.81 in 2011 due to factors such as inflationary pressures and increased economic uncertainties. The subsequent years saw a general upward trend in exchange rate volatility, reaching 98.18 in 2015 and peaking at 109.64 in 2021. This increase can be

attributed to several factors, including external shocks, fluctuating commodity prices, and increased economic pressures from the COVID-19 pandemic, which exacerbated volatility and currency instability (IMF, 2020; World Bank, 2021).

4.3 Correlation Analysis

analysis Correlation was instrumental in identifying the strength and direction of relationship between FDI and instruments of fiscal policy. This relationship can manifest as positive, negative, or neutral. A correlation coefficient approaching +1 indicated a suggested positive correlation, while a coefficient close to -1 a strong negativ strong e correlation or no (Field, 2022). Conversely, if the value was 0, it implied correlation neutral correlation.

Table 4.2: Correlation Matrix Analysis

Covariance Analysis: Ordinary
Date: 05/01/24 Time: 14:46
Sample: 2002 2021
Included observations: 20

Correlation t-Statistic Probability	FDI	TAX	REX	EXT	CER
FDI	1.000000				

TAX	0.573509	1.000000			
	2.970208	-----			
	0.0082	-----			
REX	0.516856	0.043565	1.000000		
	2.561507	0.185009	-----		
	0.0196	0.8553	-----		
EXT	-0.457851	0.161848	0.355415	1.000000	
	-2.184963	0.695837	1.613227	-----	
	0.0424	0.4954	0.1241	-----	
CER	0.391773	0.734743	-0.394264	0.235535	1.000000
	1.806567	4.595378	-1.820157	1.028220	-----
	0.0876	0.0002	0.0854	0.3175	-----

Source: Author's computation based on E-Views 10

From Table 4.2, it was observed that Tax Incentives (TAX) showed a moderately positive significant correlation with the growth rate of the Foreign Investment Direct Inflow (FDI), with a measured coefficient correlation of 0.573509 (p = 0.0028). Recurrent expenditure (REX) also exhibited a positive significant relationship with the FDI Inflow, having a correlation of coefficient 0.516856 (p = 0.0196). Additionally, External Debt (EXT) having a coefficient correlation of -0.457851 (p = 0.0385) shows a moderately significant strong negative correlation with the FDI Inflow. On the other hand, the Currency Rate Exchange (CER) had a moderately with positive the correlation FDI Inflow, determined by correlation coefficient of 0.391773 (p = 0.0876). The coefficients correlation between the explanatory variables absence indicated the of multicollinearity, as values were all below 0.9 (Kalnins, 2018)

4.4 Test for Stationarity

According to Smith and Johnson (2018), stationarity refers to the constancy of a series' mean, variance, and covariance over time, indicating time-invariance. Conversely, if the series exhibits changes in mean, variance, and covariance over time, it is classified as non-stationary and likely contains unit roots. In unit root testing, emphasis is placed on the absolute value rather than the signs (+ or -). The hypothesis null the presence assumes of a root in the unit series. The decision criterion involves comparing the absolute Dickey-Fuller value of the Augmented (ADF) statistic to critical values. If ADF the statistic's absolute value is below, the null the critical is not values hypothesis rejected, suggesting stationarity (Johnson, 2016). Conversely, if the ADF statistic's absolute surpasses the level value at a 5% significance critical value, the null hypothesis is rejected, indicating non-stationarity. Furthermore, less should be than 0.05 the p-value for significance.

Table 4.3: Dickey-Fuller Unit Root Test At Levels

Variables	ADF T-statistic	Prob	Critical Values			Conclusion
			1%	5%	10%	
FDI	-2.42002	0.3587	-4.5326	-3.6736	-3.2774	Unit Root
TAX	-2.7144	0.2420	-4.5326	-3.6736	-3.2774	Unit Root
REX	-1.8436	0.6432	-4.5326	-3.6736	-3.2774	Unit root
EXT	-4.9933	0.0184	-4.7384	-3.7597	-3.3249	Stationary
CER	-1.8603	0.9639	-3.8315	-3.0299	-2.6552	Unit root

Source: author's computation based on E Views 10.

Table 4.3 showed that FDI had an ADF test statistics value of -2.42002. Since only absolute value is considered and non-stationarity not signs, 2.42002 < 1%, 5%, 10% critical values (4.5326, 3.6736, 3.2774), thus the null the hypothesis rejected to was not confirm in series. TAX had an absolute value of 2.7144 < 1%, 5%, and 10% critical values (4.5326, 3.6736, 3.2774), meaning the series was nonstationary. Similarly, REX has ADF test statistics absolute value of 1.8436< 1%, 5%, 10% critical value (4.5326, 3.6736, 3.2774), thus the null hypothesi rejected s could not be the of presence unit confirming roots. CER has ADF test statistics absolute value of 1.8603 < 1%, 5%, 10% critical value (3.8315, 3.0299, and 2.6552), null accepted hypothesis was hence the confirming the presence of unit roots. FDI, TAX, REX, and CER have p-values of P value of 0.3587, 0.2420, 0.6432, and 0.9639 respectively which were more than 0.05 significance levels, hence they have unit roots.

EXT has ADF test statistics absolute value of 4.9933 >1%, 5%, and 10% critical values (4.7384, 3.7597, 3.3249), and p-valu null e 0.0184 < 0.05, hence the hypothesis could be rejected indicating the series was stationary. Overall, only EXT was stationary at levels. Therefore, FDI, TAX REX, and CEX were unit subjected to root at first test difference.

Table 4.4: Dickey-Fuller Unit Root Test At First Difference

Variables	ADF test statistics z(t) value	Mackinnon Approximate P-value	test critical values at 1 %	test critical values at 5 %	test critical values at 10%	Conclusion
FDI	-4.813883	0.0014	-3.857386	-3.040391	-2.660551	Stationary
TAX	-4.556712	0.0103	-4.51559	-3.690814	3.286909	Stationary
REX	-4.767642	0.0070	4.51559	-3.690814	-3.286909	Stationary
CER	-3.981570	0.0404	-3.920350	-3.065585	-2.673460	Stationary

Source: Author's computation based on EViews 10.

The indicated table FDI has an ADF test statistics value of 4.813883 was greater than the critical values of 35386, 3.040391, and 2.660551 at 1%,5%,10%, thus null the hypothesis was confirm rejected to in the stationarity series. Also, FDI has a p-value of 0.0014 < 0.05, implying there were no unit roots in the series. TAX has ADF test statistics absolute value of 4.556712 > 1%, 5%, 10% critical value (3.626784, 2.945842, 2.611531), and p-value 0.0103<0.05, the thus rejection null of the hypothesis confirming stationarity. REX ADF test statistics absolute value of 4.7662 > 1%, 5%, 10% critical values (4.51559, 3.690814 and 3.286909) and p-value 0.007<0.05, hence null the hypothesis was rejected meaning the series was stationary. Similarly, CER has an ADF statistic of 3.981570 which was greater than the critical values 1%, 5%, 10% (3.920350,3.029970) and a P value of 0.0404 < 0.05 hence the study hypothesis rejected the alternative null and that CER accepted the stationary was.

Papertudy then run a multiple regression analysis after verifying that all the variables were stationary (Refer to section 4.5 on regression analysis)

4.5 Test for Multicollinearity

Multicollinearity arises there when is leading to substantial among independent correlation variables, increased standard erors, reduced t-statistics, and elevated p-values, thereby

diminishing the statistical significance of predictors within the model (Smith, 2020). The study utilized Variance Inflation Factors (VIF) as a measure to detect multicollinearity. The criterion stipulated that a severe below VIF value ndicates10 i a lack of multicolinearity, necessitating no intervention. Conversely, a VIF exceeding 10 indicates a pronounced presence of multicollinearity in the model.

Table 4.8: Variance Inflation Factor Test for Multicollinearity

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
DTAX	1705723.	10.84181	1.039383
DREX	437.5945	10.44543	1.158498
EXT	118.5193	26.46492	1.187403
C	111302.1	30.21361	NA

Source: Author's based computation on ViewsE 10.

The centered considered VIFs are interpreting while the results. From the table TAX, REX, and EXT VFI have values of 1.039383, 1.158498, and 1.187403 respectively, which are lower multicollinearity than 5. This indicates the absence of within the model.

4.6 Multiple Regression Analysis

Table 4.8 indicated was that the suitable model in of both of fit significance goodness and terms overall statistical, as shown by an R^2 of 0.735668 and an probability F-statistichow value of 0.000070. The findings s that 73.5668% of the variation in Foreign Direct Investment Inflow was for by variables the accounted model independent in the, with the remaining 26.4332% attributed to factors not examined in this study. The model variables were statistically significant in explaining Foreign Direct Investment Inflow at a 5% of level significance, on based the F-statistical probability of value 0.000070.

Table 4.5: Multiple Regression Analysis Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DTAX	0.290502	0.060373	4.811738	0.0002
DREX	0.257703	0.107264	2.402518	0.0288
EXT	-0.338091	0.107189	-3.154145	0.0061
C	0.102659	0.033371	3.077131	0.0072

R-squared	0.735668	Mean dependent var	53.40805
Adjusted R-squared	0.686106	S.D. dependent var	48.47782
S.E. of regression	2.714347	Akaike info criterion	14.22218
Sum squared resid	1.178828	Schwarz criterion	14.42132
Log likelihood	-13.82217	Hannan-Quinn criter.	14.26105
F-statistic	14.84333	Durbin-Watson stat	1.959410
Prob(F-statistic)	0.000070		

Source: Author's computation based on E Views 10

DISCUSS YOUR STUDIES INTENSELY COZ THIS IS WHERE YOUR THESIS IS BEFORE YOU GIVE POST ESTIMATION TESTS GIVE A CRYSTAL CLEAR CONCLUSION ABOUT THE EFFECT OF FISCAL INSTRUMENTS ON FDI

4.7 Post Estimation Diagnostic Tests KINDLY REFER TO LITERATURE AND ONLY PRESENT WHAT IS REQUIRED. YOU CANNOT DO ALL THESE TEST. WHAT YOU NEEDED TO TEST IS THE ERROR TERM NOTHING ELSE AS A POST ESTIMATION TEST

4.7.1 Test for Serial Correlation/Autocorrelation

Wooldridge (2019), autocorrelation in a time series occurs when error terms from one period carry over to subsequent periods or when error terms in one period are influenced by those in another period. In linear regression, it is expected that successive error terms are independent. The study the used Breusch- Serial Godfrey Correlation. to Test examine autocorrelation

within the model. The hypothesis null, H0: $p > 0.05$, suggests the absence of autocorrelation, whereas the alternative hypothesis, H1: $p < 0.05$, existence suggests of autocorrelation the.

Table 4.6: Breusch-Godfrey Test

Breusch-Godfrey Serial Correlation LM Test:
Null hypothesis: No serial correlation at up to 2 lags

F-statistic	0.173146	Prob. F(2,14)	0.8428
Obs*R-squared	0.482761	Prob. Chi-Square(2)	0.7855

Source: Author's computation based on EViews 10.

The Chi-Squared (2) probability threshold from the table for the given R-squared value is 0.7855, exceeding the of 0.05. Thus, the hypothesis null stands while alternative hypothesis is dismissed, indicating no autocorrelation is present in model the. Therefore, the null upheld hypothesis is with a 5% significance level of.

4.7.2 Test for Heteroscedasticity

According to Gujarati and Porter (2009), homoscedasticity in a function requires error that the terms exhibit equal regression variance. examine for the presence of heteroscedasticity in the model, the utilized the study Breusch test. T-Pagan he null hypothesis, H0: $p > 0.05$, assumes no heteroscedasticity, while the alternative hypothesis, H1: $p < 0.05$, suggests the heteroscedasticity presence of.

Table 4.7: Breusch-Pagan-Godfrey Test

Heteroskedasticity Test: Breusch-Pagan-Godfrey
Null hypothesis: Homoskedasticity

F-statistic	2.910527	Prob. F(3,16)	0.0666
Obs*R-squared	7.061078	Prob. Chi-Square(3)	0.0700
Scaled explained SS	3.313721	Prob. Chi-Square(3)	0.3457

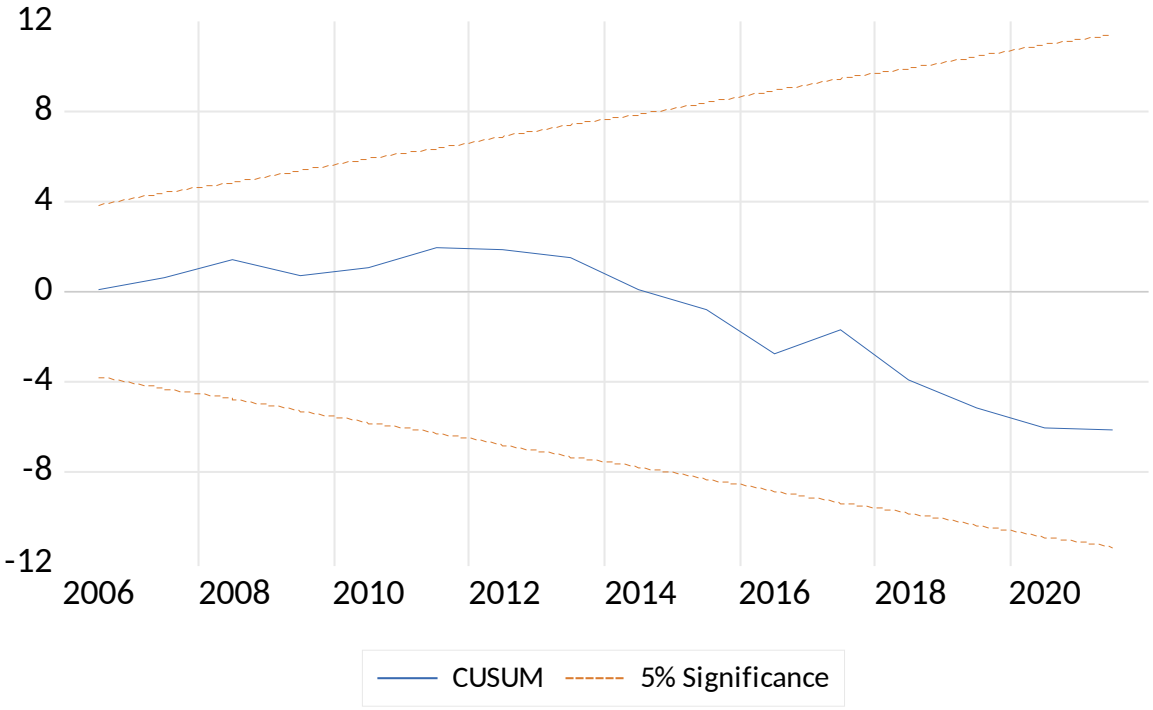
Source: Author's based computation on E Views 10.

The calculated which table probability shows that value has the R-squared a Chi-Square (3) of 0.0700, is above 0.05. Therefore, the concludes accepting that there researcher is the model no heteroscedasticity in by the null and hypothesis at level of a 5% significance the alternative rejecting hypothesis.

4.7.3 CUSUM Test for Model Stability

Figure 4.2 demonstrates that variables in all the model fall the 5 within % threshold, indicating model's the stability as confirmed by Zeilleis (2004).

Figure 4.7: CUSUM Test for Model Stability



Source: Author's EViews 10.computation based on

4.8 Hypotheses Testing

The was results in Table 4.10 utilized to however, verify below the assumptions were made in the analysis. If the p-value exceeds 0.05, the null was null hypothesis was rejected; if it 0.05, the hypothesis accepted.

Table 4.9: Hypotheses Results

Hypotheses	What is expected	P-Values	Verdict
Ho1	There is no link significant between Tax Foreign Incentives and Direct Investments in Kenya	p=0.0002	Reject
Ho2	Recurrent has no t Investment significant effect on Foreign Direc Inflow Expenditure	P=0181	Reject
Ho3	External has no Investment significant effect on Debt Direct Foreign	P=0.0077	Reject
Ho4	There Intervening is no Effect of Currency Exchange rate on the Association Foreign Direct between the fiscal policy instruments and Investment Inflow.	P 0.0007	Reject

Source: Researcher, (2024)

Use APA format of table

4.9 Results and Discussions as Per the Study Objectives

The main objective Incentives of this determine research was to the effect of Tax, Recurrent Expenditure, and external Debt on Foreign Direct Investment Inflow. Necessary independent diagnostic variables tests have indicates that been completed and the model are statistically important in clarifying FDI Inflow.. The obtained regression from equation the analysis is;

$FDI_t = 0.102659 + 0.290502TAX_{t1} + 0.25703REX_{t2} - 0.338091EXT_{t3} + \mu$

Where; FDI = Foreign Direct Investment Inflow.

TAX_t = Tax Incentives (Measured as Income tax as Corporate a percentage of total GDP).

REX_t = Recurrent GDP as a proportion expenditure of the total (measure for recurrent expenditure)

EXT_t = External Debt as a of total GDP (measure proportion for External debt in the study)

μ = the term error

t = quarterly series time

4.9.1 Effect of Tax Incentives on Foreign Direct Investment Inflow.

The null initial hypothesis (H_{01}) in this study, hypothesized was which that there no between link Tax Incentives and was rejected Foreign in based Kenya,on the regression outcomes Direct Investments displayed in Table 4.9. In particular the p-, for Tax value Incentives (TAX) was measured at 0.0002, which is lower than 0.05. This showed influx a major of Tax Incentives Foreign impact on the of Direct Investment in Kenya. Moreover, the variable was found to have a coefficient (β_1) of 0.290502. This coefficient shows that, other constant holding all, a 1% rise in factors Tax Incentives results in a 29.0502% growth in Foreign Direct Investment Inflow in the near future.

This finding implied that corporate income tax expenditure can as a tax incentive potentially increase Foreign Direct Investment Inflows by making the country more attractive for investors, enhancing competitiveness, and encouraging investment in specific sectors. Hence, this result aligns with the research done by Abille et al. (2020) on the relationship between fiscal incentives and foreign direct investment (FDI) in Ghana. Their findings indicate that there is a positive short-term relationship between tax policies and FDI inflows. This further supports Kariuki's (2023) findings that in companies Kenya impact corporate listed manufacturing taxation attract has a on the a significant bility of to investors.

Abdioglu and Nida (2016) examined how tax Cooperation policies countries that affect (OECD). Foreign Direct in are part of the for Economic and Development They Organization categorized Investment the countries into those implementing tax cut policies and those that do not. They analyze the correlation between the two groups of using time- findings series analysis. indicate nations that taxes h y discover ave a influence on considerable Foreign Their Direct Investment. Furthermore, reductions in the that tax policies have diverse effects on FDI in different countries, with high tax rates being linked to a decrease in FDI.

The study similar to Kyule's (2018) study incentives which focused on assessing significantly influenced the foreign direct effect of conducted but inflation rates is not tax on the FDI inflows are not flow of investment (FDI) in Kenya. The results showed that by individual tax incentives, interest rates, and economic growth, are a significant factor..

This study also differs from those conducted by Briyima, et al., (2015) who Direct sought to determine foreign the of tax impact incentives on investors' decisions to engage in FDI (Foreign Investment). Tax incentives were calculated by comparing annual tax revenue to GDP. The results showed that tax had a notable direct investment benefits adverse on foreign. Nevertheless, this impact study focused on the Corporate Income Tax Expenditure.

4.9.2 Effect of Recurrent Expenditure on Foreign Direct Investment Inflow

Recurrent Expenditure has probability value the of 0.0288 was than less 0.05, showing that it is significant statistically when explaining FDI Inflow. Recurrent Expenditure had a positive sign in the model as expected, implying that it has a relationship positive with Inflow FDI, therefore, an escalation in Recurrent Expenditure would result in an increase in Foreign Directcross border investment flow. The 0.257703 coefficient of means that if Recurrent Expenditure rises by one percent, Foreign Direct Investment Inflow increases by 0.257703

percent on average Ceteris Paribus. This trend can be explained by the fact that strategic government spending on recurrent items like salaries, maintenance, and operational expenses can enhance infrastructure, create a favorable business environment, and bolster confidence in the economy's stability, ultimately attracting higher levels of Foreign Direct Investment into a country like Kenya (Roubini and Mihm, 2020).

This study was in with the study by Abonazel & Shalaby (2020). Performed a research project to examine the factors influencing net foreign direct investment (FDI) inflows in 23 countries through the application in the MENA concurrence region from 1995 government has a major influence on the net panel to 2017 of static and dynamic data analysis. The findings of money spent by the foreign showed that the amount inflow of direct investment.

The study by Onifade et al. (2020) examined the effects of spending on public economic Nigeria. Specifically, it looked at growth in recurrent the impact and expenditures as well as government fiscal expansion on various sectors of the economy. The research utilized Pesaran's ARDL method to examine of capital how public spending indicators impact economic growth. The research showed that ongoing expenses had a notable adverse effect on economic expansion, whereas the beneficial effects of government investments in capital were found to be insignificant on investment and economic growth, making this study distinct from previous findings.

4.9.3 Effect of External Debt on Foreign Direct Investment

Debt External has a probability value of 0.0061<0.05, hence a confirmation that the currency exchange rate was statistically significant in explaining Foreign Direct Investment Inflow. External negative Debt had a sign as expected, which means and Foreign Direct External

Debt Investment Inflow are inversely related. Therefore, as the External coefficient Debt rises, Foreign Debt causes Direct Investment Inflow is expected to decline. -0.338091 for External Debt implies that an upward unit percentage change in External a 33.8091% decrease in Foreign Direct Investment Inflow on average Ceteris Paribus. The explanation for this trend was that with a significant increase in external debt, it may need to a larger allocate portion of its debt resources to servicing and repayment. This can lead to a reduction in funds available for investment in other areas, including Foreign Direct Investment. In this scenario, the increase in external debt could potentially crowd out FDI Inflow as resources are diverted to debt obligations.

This study was in agreement with the one by Muinga (2014) who study on the nexus between external sought to debt, foreign dirct economic growth. the results suggested that foreign The investment and payments have debt and interest economic payments a detrimental on external debt impact on Kenya's growth.

The paper study was not in agreement with Julie (2018) who a descriptive employed research approach and utilized a multivariate linear regression the correlation model to examine between significantly public on debt and public FDI inflow. The study employed the Vector Error Correction Model and found that, its own, debt does not affect FDI inflows in Kenya, which was a key focus of this research.

In addition, the study differed with Kiunga (2018) who carried out research to investigate how external impacts government borrowing the inflow of foreign direct investment in Kenya. The variable analyzed was external government borrowing in natural logarithm form,

specifically measured by quarterly data on external government borrowing. The research utilized a vector error correction model equation, and descriptive research design, and employed regression a multiple model to examine the connection the variables among. The research found that government debt and economic growth do not independently impact FDI inflows in Kenya, unlike in the current study.

4.9.4 The Intervening Effect of Curren,cy Exchange rate on the Association between the fiscal policy instruments and Foreign Direct Investment Inflow.

According to Hayes (2018), an intervening variable modifies the connection between explanatory variables dependent the and variable. This comprehension allowed the researcher to ascertain the true magnitude of association between independent variables like Tax Incentives, Recurrent expenditure, and External Debt and the dependent variable, namely Foreign Direct Investment Inflow. Variations in R-squared values served as an indicator to influence measurethe of the intervening variable.

Table 4.10: Regression Output Without Currency Exchange Rate

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DTAX	0.290502	0.060373	4.811738	0.0002
DREX	0.257703	0.107264	2.402518	0.0288
EXT	-0.338091	0.107189	-3.154145	0.0061
C	0.102659	0.033371	3.077131	0.0072

R-squared	0.735668	Mean dependent var	53.40805
Adjusted R-squared	0.686106	S.D. dependent var	48.47782
S.E. of regression	2.714347	Akaike info criterion	14.22218
Sum squared resid	1.178828	Schwarz criterion	14.42132
Log likelihood	-13.82217	Hannan-Quinn criter.	14.26105
F-statistic	14.84333	Durbin-Watson stat	1.959410
Prob(F-statistic)	0.000070		

S

ource: Author’s computation based on EViews 10.

Table 4.11: Regression Output with Currency Exchange Rate as an Intervening Variable

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DTAXM	0.812686	0.134758	6.030707	0.0000
DREXM	0.827033	0.303837	2.721961	0.0151
EXTM	-0.374715	0.122931	-3.048184	0.0077
C	0.101352	0.024200	4.188003	0.0007

R-squared	0.742095	Mean dependent var	53.40805
Adjusted R-squared	0.693738	S.D. dependent var	48.44778
S.E. of regression	2.681146	Akaike info criterion	14.19756
Sum squared resid	1.150167	Schwarz criterion	14.39671
Log likelihood	-13.79756	Hannan-Quinn criter.	14.23644
F-statistic	15.34612	Durbin-Watson stat	2.191748
Prob(F-statistic)	0.000057		

S

ource: Author's computation based on EViews 10.

First table without shows that the Currency Exchange Rate as an intervening variable, R^2=0.735668, on the other hand, the second table indicates that when the Exchange Currency Rate is added in the intervening model as an variable R^2=0.742095. This means that the intervention of the Currency Exchange Rate caused Tax Incentives, Recurrent expenditure, and External Debt to jointly explain 74.2095% variation in Foreign Direct Investment Inflow from 73.5668%. Therefore, the variables independent jointly explain the variation in the dependent variable by an additional 0.6427% through the intervention of the Currency Exchange Rate. Furthermore, the F- statistics probability value in the second table is 0.000057 which e p value is less indicating than e intervention th of 0.05, that th of the Currency Exchange Rate is statistically significant. The results can be explained by the fact that when the Exchange Rate is stable, it trickles down to increase the tax incentives (through the increase of Corporate Income tax expenditure), Increase recurrent expenditure geared towards FDI, and reduce external debt that will increase the direct the long investment inflows foreign in run. On the debt which contrary, if the external exchange rate was unstable

it would contribute to a decrease in recurrent expenditure reducing the development expenditure, reducing tax incentives, increase as a result will contribute to a drop in the Foreign direct investment inflow.

CHAPTER FIVE

SUMMARY, CONCLUSION AND POLICY RECOMMENDATION

5.1 Introduction

This provides chapter a brief overview of study the results and on the conclusions study. It also provides and implications policy recommendations and acknowledges the of study limitations, and suggests avenues for research future.

5.2 Summary of the Findings

Study sought to examine effect Selected Fiscal Policy instruments (Tax incentives, Recurrent Expenditure, and Debt External) on Foreign Direct inflow Interest, Kenya, with

the Currency Exchange rate as an intervening variable. study The adopted correlational descriptive, research and causal designs to analyze variables. Descriptive statistics were computed to observe the standard mean, deviation, minima and peak values, skewness of the and kurtosis variables sample and check if any outliers were present.

The results indicated that Foreign Direct Investment Inflow had moderately positive skewness (leptokurtic). However, Tax Incentives showed a slightly flatter distribution than normal (Platykurtic) skewed slightly negative. Whereas Recurrent Expenditure, External Debt, and currency exchange rate, positive skewness with elongated right tails and (leptokurtic) distributions.

Pearson's correlation was also conducted using raw data to establish statistical relationships between variables. The findings indicated that Direct foreign Investment Inflow Tax Incentives had significant moderately positive correlation. Recurrent Expenditure also exhibited a significant relationship positive FDI with Inflow. External Debt, on other the hand, had strong a negative correlation with the Dependent variable while the currency exchange rate has a marginally positive association with inflow FDI.

Test of Augmented-Fuller Dickey (ADF) was also check used to if the root unit the were present in variables. Findings indicated that External Debt was stationary at level *1(0)* and needed no differencing. Foreign Direct Investment Inflow, Tax Incentives, the recurrent expenditure, and the Currency Exchange Rate attained stationarity after applying the first difference *1(1)*. Regression was analysis also carried out to determine the coefficients and statistical significance of independent variables in explaining changes in the dependent

variable. Breusch-Godfrey Test showed that there was no autocorrelation in the regression residuals. Furthermore, the Pagan Breusch- -Godfrey Test revealed that the model contained regression no heteroscedasticity. The Variance Inflation Factors (VIF) test similarly found no multicollinearity in the model. Additionally, Jarque-Bera the statistics indicated test regression that the residuals were distributed. The normally CUSUM test for model stability revealed that the variables in the model fitted inside the 5% border, indicating that the model was stable. The findings summary of according to the were as objectives follows.

5.2.1 Effect of Tax Incentives on Foreign Direct Investment.

The first objective was to investigate the impact Investment of Incentives Tax on the of Influx Foreign Direct in Kenya. Tax Incentives were represented by Corporate Income Tax Expenditure GDP proportion of. The statistics descriptive revealed that Tax Incentives had an average of 0.1455%, a least value of 0.2400%, and apeak value of 0.050%. The analysis correlation of results indicated a moderately correlation significant positive between Tax Incentives and the Influx of Foreign Direct Investment, with a correlation of coefficient 0.0573509 (p= 0.0028). Furthermore, results obtained from the analysis regression showed substantial impact positive of Tax Incentives on the Influx of Direct Foreign Investment Kenya. in The computed value the of regression coefficient (β1) 0.290502 (p = 0.0002).

5.2.2 Effect of Recurrent Expenditure on Foreign Direct Investment Inflow

The objective second of the study aimed at investigating effect the of Recurrent Expenditure on direct Foreign investment inflow in Kenya. findings indicated that is there a noteworthy positive between association recurrent spending and Foreign Direct Investment Inflow, with a moderate correlation indicated by the correlation of coefficient 0.573509 a p-value of

0.0196. The and regression results model show Recurrent that Expenditure has a positive coefficient of 0.257703, which is said to be significant statistically because the is p-value 0.0288 is which than less 0.05. This implies that recurrent has expenditure a positive effect on Direct Foreign Investment Inflow in Kenya. The coefficient of 0.257703 implies other keeping variables all consistent, a increase unit in recurrent expenditure increases Foreign Direct Investment Inflow added by 0.257703 units.

5.2.3 Effect of External Debt Direct Foreign Investment Inflow.

The specific third objective on the impact of Debt External on the of foreign inflow direct investment in Kenya was examined. External Debt was as a percentage measured of GDP. The results indicated a correlation moderately negatively significant the external Investment Debt and Foreign between Direct Inflow, and the weak is as by indicated relationship the correlation value coefficient of -0.457851 (p=0.0876). From the model regression results, the currency exchange rate has a negative coefficient of -0.338091. The coefficient shows statistical significance due to the p-value being 0.0061, which is below 0.05. indicates that This the External Foreign Debt has a effect on Direct Investment negative Inflow in Kenya. -0.338091 means holding that other factors all constant, a rise in the unit External decrease Debt leads to direct a in foreign investment units by 0.338091.

5.2.4 The Intervening Effect of Currency Exchange Rate on the Association between the Fiscal Policy Instruments and Foreign Direct Investment Inflow in Kenya

The results that showed the Currency rate Exchange has a positive significant intervening effect on the association between explanatory variables (Tax Incentives, Recurrent Expenditure, Debt and External) and variable dependent (Foreign Direct Investment Inflow).

Model's R2 value increased from 0.735668 to 0.742095 with the inclusion of the currency exchange rate, indicating that the independent variables collectively explain a further 0.006427% of the dependent variation the in variable. Additionally, the intervention of the Currency Exchange is F-statistic's statistically as significant Rate probability is the 0.000057<0.05.

5.3 Conclusion

Based study's on the specific objectivity, the following endings were drawn from the empirical findings.

5.3.1. Effect of Tax Incentives on Foreign Direct Investment Inflow.

The study showed findings that Incentives Tax a considerable had favourable on Foreign Direct impact Investment. As a result, the hypothesis that statistically suggests there is no significant impact of Tax Direct incentives on Foreign Investment Inflow in Kenya was dismissed at a 5% significance level.

5.3.2 Effect of Recurrent Expenditure on Foreign Direct Investment Inflow.

According study to the, recurrent has a considerable expenditure beneficial on effect Kenya's foreign investment direct inflow. As a result, the hypothesis there was null that no statistically significant influence of recurrent expenditure on direct accepted foreign investment inflow in Kenya was rejected, and the alternative was hypothesis that recurrent expenditure had significantly influence FDI inflow Kenya.

5.3.3 Effect of External Debt on Foreign Direct Investment Inflow

On the third objective, the stloan found that had a debt considerable impact negative on foreign investment direct inflows. As a the hypothesis null, which claims result,that external

debt has no significant influence statistically on foreign in investment direct inflows Kenya, was rejected at the of significance 5% level. This indicated that when external the debt increased, direct foreign investment inflows decreased.

5.3.4 Moderating Effect of Exchange Currency Rate on the relation between Selected Fiscal Policy Instruments and Foreign Variables Direct Investment Inflow in Kenya.

The found analysis that the Currency Rate has Exchange a considerable impact on the relationship between the selected fiscal policy tools (Tax Incentives, Recurrent Expenditure, and External Debt) and Foreign Direct Investment Inflow. Thus, the null hypothesis, which proposes that Currency Rate significant Exchange not have does a mediating result on the influence of selected fiscal variables policy tools on Foreign Direct Investment Inflow in Kenya, was rejected.

5.4 Recommendations

The study findings found significant positive contribution of Inflows Tax Foreign Incentives to Direct Investment. To enhance Foreign Direct Investment (FDI) Inflow, policymakers should strategically optimize tax incentives, including Corporate Income Tax (CIT). This entails revisiting tax structures, tailoring incentives for specific industries or regions, and prioritizing transparency in tax policies to foster investor confidence. By fine-tuning tax incentive programs effectively, authorities can create a more attractive investment climate, stimulating increased FDI inflows and growth supporting economic.

Results of the showed study that recurrent spending had a noteworthy beneficial impact on the Inflow of Direct Foreign Investment in a meaningful way. The government was advised by the study to utilize the national treasury to increase budget allocations towards recurrent expenditure. This strategy aims to amplify the beneficial effects of recurrent expenditure,

thereby significantly enhancing FDI inflows. The government should implement measures to ensure that a significant portion of recurrent expenditure fosters activities that directly and indirectly encourage Foreign Direct Investment Inflows..

Given the significant negative effect of external debt on FDI, policymakers should prioritize strategies to manage and reduce external debt burdens responsibly. This may involve exploring alternative financing mechanisms, enhancing debt sustainability frameworks, and promoting prudent fiscal management practices to mitigate potential associated risks with high external levels of debt.

Recognizing the significant intervening effect of exchange rates of the currency on the relationship between fiscal policy instruments and FDI, policymakers should closely monitor and manage currency fluctuations. Implementing measures to stabilize exchange rates, such as prudent monetary policies and foreign exchange market interventions, can enhance predictability and reduce volatility, thereby positively influencing FDI inflows.

5.5 Areas for Further Research

The paper recommended further research build study to on the findings. Different measures should be used on the same variables to see if the effect would have a positive, or negative or remain the same. For instance, a different research should use a different measure of Investment Incentives such as Capital Allowance, Investment Deduction, withholding tax expenditure, and also use a different moderating variable such as the rate Inflation to replace the real effective exchange rate to see if it will have a similar trend. Besides, a different study should build on this study by including omitted variables that affect the FDI Inflow such as tax rate, development expenditure, and Urbanization.

The study applied series time analysis and the Least Ordinary Squares (OLS) estimation method. One can conduct a comparable analysis to examine how fiscal policy tools impact the Inflow of Direct Foreign Investment in various countries like those in East Africa, employing data both panel analysis and Distributed the Autoregressive model Lag (ARDL).

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APPENDIX I: Map of Kenya

Source: Government of Kenya (2019)

APPENDIX II: Data

Year	FDI Inflow (KES Millions)	Tax Incentives(Corporate income tax expenditure % of GDP)	Recurrent Expenditure(% of GDP)	External Debt(% of GDP)	Currency Exchange Rate (Exchange Rate Volatility)
2002	27.62	0.10	10.49	36.8	78.73
2003	81.74	0.13	11.07	39.2	75.94
2004	46.06	0.11	11.20	36.6	79.24
2005	21.21	0.12	11.88	32.2	75.55
2006	50.67	0.13	13.40	27.9	72.10
2007	729.04	0.15	13.23	21.7	67.32
2008	95.59	0.09	15.35	21.1	69.19
2009	116.26	0.06	4.42	23.3	77.35
2010	178.06	0.05	4.80	23.5	79.23
2011	1450	0.17	4.97	25.9	88.81
2012	1380	0.16	5.61	19.2	84.53
2013	1120	0.15	6.38	18.8	86.12
2014	820	0.16	5.90	22.5	87.92
2015	619	0.14	6.15	25	98.18
2016	469	0.17	6.93	27.3	101.50
2017	1350	0.20	7.82	30.3	103.41
2018	767.76	0.24	8.48	29.1	101.30
2019	469.94	0.19	9.07	30.4	101.99
2020	426.31	0.21	9.77	35.3	106.45
2021	463.35	0.18	9.92	34.5	109.64

Source: KNBS, CBK,KRA, World Bank, IMF, and UNCTAD websites.

APPENDIX III: Research Permit

REPUBLIC OF KENYA

NATIONAL COMMISSION FOR SCIENCE,TECHNOLOGY & INNOVATION

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Date of Issue: **17/April/2024**

RESEARCH LICENSE

This is to Certify that Mr.. Terence Makatiani of Masinde Muliro University of Science and Technology, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Kakamega on the topic: Effect of Selected Fiscal Policy Instruments on Foreign Direct Investment Inflow in Kenya(2002-2021) for the period ending : 17/April/2025.

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APPENDIX IV: Approval

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Ref: MMU/COR: 509099 4th April2024

Makatiani Terence
ECO/G/01-70638/2021
P.O. Box 190-50100,
KAKAMEGA.

Dear Mr. Makatiani

RE: APPROVAL OF PROPOSAL

I am pleased to inform you that the Directorate of Postgraduate Studies has considered and approved your masters proposal entitled ***"Effect of Selected Fiscal Policy Instruments on Foreign Direct Investment Inflow in kenya (2002-2021)"*** and appointed the following as supervisors:

1. Dr. Consolata Ngala - SOBE, MMUST
2. Dr. Angela Mungai - SOBE, MMUST

You are required to submit through your supervisor(s) progress reports every three months to the Director Postgraduate Studies. Such reports should be copied to the following: Chairman, School of Business and Economics Graduate Studies Committee and Chairman, Economics Department. Kindly adhere to research ethics consideration in conducting research.

It is the policy and regulations of the University that you observe a deadline of two years from the date of registration to complete your masters thesis. Do not hesitate to consult this office in case of any problem encountered in the course of your work.

We wish you the best in your research and hope the study will make original contribution to knowledge.

Yours Sincerely,

Prof. S. Odebero, PhD, FIEP
DIRECTOR, DIRECTORATE OF POSTGRADUATE STUDIES