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APPENDIX I: Correlation analysis[37]

Correlation analysis is a statistical tool that attempt to explain the degree of association between two or more economic variables such as foreign investment and tax burden (Wilson & Keating, 1998:70). This statistical technique answer the question: is there a significant (linear) association (negative or positive) between two variables? To measure such association quantitatively using correlation analysis, statisticians, and economists follows sequential steps. Firstly, a correlation coefficient is calculated. Secondly, a testing of significance is conducted. Thirdly, some conclusion can be drawn from the results obtained in two previous steps. This is made clear in the following paragraph.

The correlation coefficient is determined as follows:

$$r_{xy} = \frac{\sum (x_i - \bar{x})(y_i - \bar{y})}{\sqrt{\sum (x_i - \bar{x})^2 \sum (yi - \bar{y})^2}} \text{……………………… (1)}$$

Where x_i and y_i stand for the values of first and the second economic variables (i.e foreign investment and tax burden) respectively. According to Van den Honert (1999:98) the correlation coefficient lies between -1.0 and +1.0. He further notes that if two variables have no association then the correlation among such variables is zero. And a negative results shows that there is a negative association between such variables. The opposite is also true. The closer the result is to 1, it suggests a robust relationship.

Therefore, given the value of (I), it is then necessary to test its significance at various level of confidence (i.e 1% or 5%). In order to test the level of significance some hypothesis testing should be indicated (Wilson & Keating, 1998:71).

H_0: ρ=0 (no correlation at all)
H_1: ρ#0 (there is evidence of correlation)

Where, ρ is population correlation coefficient

[37] This section relies heavily on a comprehensive discussion of correlation analysis by Van den Honert (1999:93)

Then, a test statistic is conducted using the t- distribution with n-2 degree of freedom. Mathematically, t test is given by:

$$t_{obs} = r_{xy} * \sqrt{\frac{n-2}{1-r_{xy}}} \quad , \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots.. (2)$$

Where n is the sample size (the number of observations)

At later stage, taking into account the values of correlation coefficient, r_{xy}, and the value of the t statistic, the decision rule will be based on the following[38]:

- If at n-2 degree of freedom, the table value (at either 1% or 5 % level of significance) is less than the t statistic, it is concluded that population correlation coefficient, ρ is different from 0. Statistically this shows that there is evidence of correlation. As result the H_1 hypothesis is accepted.

It is important to note that although level of significance is an assurance that the variables are correlated, the interpretation of correlation coefficient should be done with a great deal caution (Van den Honert (1999:101). This is because correlation coefficient measures accurately only the degree of linear relationships among variables and it does prove to explain the same association of non linear data unless some mathematically transformations are undertaken. Secondly, correlation does not explain in detail the cause and effect relationship among variables. That is, there is probability that some unrelated variables can be highly correlated and thus producing spurious results (Wilson & Keating, 1998:70).

[38] Statistical tables should be used and for this analysis t distribution is often applied. It can be either one or two sided test.