The Impacts of Foreign Direct Investment on Economic Growth in Tanzania from 1998 to 2018

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Abstract

Foreign Direct Investment (FDI) is one amongst the foremost of the most prominent features of the global economy presently. This study conducts an empirical analysis of the impact of Foreign Direct Investment on the economic growth of Tanzania. The data for this research was collected from World Investment Reports, IMF, World Bank, and the Bank of Tanzania (BOT); the analysis was just based on time series data for the year 1998-2018 From the research, the study found out that FDI has a notable contribution to the economic growth in Tanzania and the results show that the more FDI the more the economic growth. When FDI increases by 1 million USD, the GDP will be increased by 0.396519 million USD other factors remaining constant. This could simply imply that an increase in FDI inflows is important to economic growth. The study suggests that it is important for the government of Tanzania to review the investment policies that will facilitate FDI inflows to proceed with having a positive impact on the local economy in Tanzania. It is also very important for the government to focus on maintaining inflation at a low rate (at a single digit). Stability in the inflation rate is a significant factor in the economy, Tanzania needs to take into account all factors which cause an increase in the general price levels and address them with policies for it attracts more investors.

Keywords: Foreign Direct Investment (FDI), Gross Domestic Product(GDP), Tanzania Investment Center (TIC), World Bank(WB), Trade Openness(OPEN), United Nations Conference on Trade and Development (UNCTD)

1. Introduction

Buckley (2000), defines foreign direct investment (FDI) as a term accustomed imply the acquisition of physical assets abroad, like plant and equipment, with operational control and eventually domicile with the parent company within the home country. FDI may soak up different forms like the establishment of the latest enterprises in a foreign country either as a branch or subsidiary, the expansion of overseas subsidiary or branch, and also the purchase of overseas business enterprise or its assets. During this process of transferring, the FDI does not only transfer ownership but also interrelated factors to capital such as technology, management jointly with organization skills. The fundamental problem under this study is the impacts of Foreign Direct Investment on Economic growth in Tanzania.

The purpose of this research is to assess the contribution of foreign direct investment towards the economic growth of Tanzania. Tanzania is one of the countries in the African continent with better performance in terms of GDP growth and attracting foreign investment inflows. With the existence of natural assets (resources), long term stable democracy strong macroeconomic performance, Tanzania has every advantage of attracting much greater FDI inflows (MIGA, 2007). Tanzania continues to be one of the top destinations for FDI in Africa, and inflows have increased dramatically in the past 15 years.

China is currently the leading foreign investor in Tanzania after leapfrogging its Western peers. This is due to the entrepreneurial aggressive nature of its people in pursuing business opportunities and searching for new markets around the world. Eight years ago, China was the sixth among countries with the largest investments in Tanzania behind the UK, the US, South Africa, and Kenya. The current estimate by the Tanzanian Investment Centre shows that China had moved into second place in 2012 before taking the top slot a few years ago (Mwambe, 2019).

The fundamental problem came due to the current endeavor of the Tanzania government to improve its economic growth through Foreign Direct Investment while there are prominent policymakers, researchers, and politicians who are still questioning the contribution of Foreign Direct Investment to our country's economic growth.

In determining the impact of FDI, this study is concentrated on six variables that include foreign direct investment, the government expenditure, human capital such as secondary school enrollment, infrastructure that attract FDI additionally to its development due to FDI, trade openness in addition as natural resources.

Empirical studies of the impact of FDI on growth are concerned with the overall effect either on growth (or net welfare) or with specific aspects of the FDI impact on employment, technology, trade, entrepreneurship and other areas of the economy, such as infrastructures, education, and health. Hence, the impact of FDI on economic growth remains unclear. It is, therefore, necessary to assess the impact of FDI on the economic growth in Tanzania.

The Study provides information as to how much FDI (by sectors) affects our country's economic development. The research is also useful to the investment authority in Tanzania, as it offers knowledge about which sector performs well in FDI inflows and which one needs enhancement. This will help them reform their policies and regulations to establish an atmosphere that is conducive to bringing more FDIs into the region. Increase of awareness to the users onthe impact that FDIs have on the Tanzanian economy.

2. Literature Review

FDI has been shown to play an important role in promoting economic growth, raising a country’s technological level, and creating new employment in developing countries (Borenzstein, De Gregorio, and Lee, 1998). It is also shown that FDI is considered as the mean which integrates developing countries into the global marketplace and thus increasing capital available for investment. This in turn leads to an increased rate of economic growth which is potential in decreasing the rate of poverty and raising the living standard of people (FAO, 2013). It is also revealed that many countries have understood the role of FDI in economic growth and thus making these countries taking steps in removing investment barriers. For example, during the 1990s, 1000 FDI laws and regulations were amended of which 94 percent were amended principally to attract FDI (UNCTAD, 2010). To attract FDI, many countries have implemented incentives including tax exemption, government pledges, tariff reduction on equipment and machinery imports, subsidy, etc. All these were made after countries proved that FDI contributes to economic growth.

According to George and Greenway (2004) when firms are part of the global economic network there is marked improvement in their outputs and capital stock quality. Foreign Direct Investment stimulates growth and enhances the productivity of local firms through facilitating and attracting investment infrastructure, human skills development, efficient technology and spurs economic development by promoting inter-business competition.

Usiri (2014) conducted a study on the effect of foreign direct investment on the economic performance of Tanzania. From his study, it was revealed that FDI inflows in the mining and quarrying sector have a positive effect on the economic growth of the country. Thus, from these findings, it is seen that the more FDI inflows increase in the mining and quarrying sector, the more the economy of the country increases. Also, Moshi (2015) on the study based on the impact of FDI on economic growth in Tanzania revealed that FDI inflow in the mining and quarrying sector has a positive impact on economic growth. Thus, FDI in the mining and quarrying sectors has a greater influence on the economic development of the country.

According to the study was done by Abala (2014) which was undertaken in Kenya, the study showed thatForeign Direct Investment is the key driver to not only economicgrowths in Kenya but also as an attraction of Foreign Direct Investment in Kenya too. The study showed that Foreign Direct Investment in mining sectors brought less significant to the economic growth of the country whilst Foreign Direct Investment in the manufacturing sector was reported to be very significant in determining the growth of the economy of Kenya. The study also reported the factors following FDI in the manufacturing sector to be very significant in economic growth which is market seeking in the manufacturing sector that favors this sector into highly contributing to economic growth which iscompared to contribution brought by other sectors for the instance mining sector, tourism sector and other service sectors.

In Nigeria, the study on the impact of Foreign Direct Investment on economic growth was undertaken by Onakoya in 2012. The study was undertaken inthe agricultural sector and manufacturing sectors to examine the impact of FDI on the growth ofthe economy of Nigeria. The study revealed the presence of impact of Foreign Direct Investment on economic growth where the significant output on the economy was reported to be brought by Foreign Direct Investment but in terms of economic growth, the FDI in those sectors were reported to vary were on the manufacturing sector, the impact on economic growth was insignificant while in the agriculture sector, the impact was found to be significant and since it’s a growing economy.

Aze (2019) carried out a study on the impact of foreign direct investment on manufacturing sector output in Nigeria. From his study, it is revealed that FDI inflow in the manufacturing sector has an insignificant relationship with the economic growth of the country. It means that foreign direct investment in the country has a little contribution tothe economic growth of the country. This provides a picture that FDI inflows in the manufacturing sector are still insufficient to be able to contribute to the increased economic growth of the country.

Foreign Direct Investments (FDIs) have grown and will continue to grow as well as playing significant roles in the development and growth of many economies in the world by contributing to the Gross Domestic Products (GDP). FDI is now defined as not only an easy transfer of money but also a mixture of financial and intangible assets. It's widely believed that economic growth depends critically on both foreign and domestic investments. FDI can affect economic growth either directly or indirectly. Among the expected benefit of FDI in the host, economies include attaining poverty reduction, economic and social transformations in general. The benefits from FDIs, however, may differ from time to time and perhaps from one country to another depending on the prevailing political, social, economical and technological situation as well as on the legal and regulatory framework on the ground.

There are many advantages of FDI both to the host country and the home country, these benefits are being noted by different authors. For instance, Alfaro (2003) said that, apart from direct capital financing it supplies, FDI can serve as a root of valuable technology and know-how to the host developing countries by stimulating linkages with local firms. These technological innovations by the MNEs play a central role in the Tanzanian economy and they are some of the most important areas where MNEs acts as a catalyst in developing countries.

Despite the benefits that can be achieved from FDI, it should be very well known that it could also bring about some negatives impact, for example, activities from MNEs that can displace local firms that don't cope with the competition from foreign firms and this is very common in developing countries thereby reducing the growth of the local firms according to Jones, 1996. Also if proper regulations are not in place in the host country, FDI can serve as a source of capital flight from the developing countries like Tanzania to the developed ones. For instance, due to some specific risks in the host country whether economic or political risks, there could be a large flow of capital from the host country to the home country like Tanzania if there is no legislation against such practice. This can hurt the host economy especially if such capital is being sourced from within the host country. Lastly, due to MNE's higher production capacity, FDI can cause large scale environmental damage which sometimes is not well taken care of especially in the mining sector a good example is the PalaBora 2002 when the pit reached its final economic depth. It should be well noted that the net contribution fount of FDI to growth can only be measured empirically.

Theoretical Literature Review

2.6.1 Theories of FDI

(a) Product life-cycle Theory

This theory was believed to be developed by Raymond Vernon in 1966, it was used to explain certain types of FDI made by U.S companies in western Europe after the Second World War in the manufacturing industry. Vernon gathered that there are four stages of production cycle which are innovation, growth, maturity, and decline. According to Vernon, In the first stage, the U.S companies created new innovative products for local consumption and exported the surplus to serve the foreign market (a form of dumping). To understand foreign direct investment one must first understand the basic motivations that cause a firm to invest in another country rather than export or outsource production to national firms. The purpose of this product life-cycle theory is to provide a theoretical explanation for both FDI and Trade. Vernon's theory is more relevant to manufacturers' initial entries into foreign markets than to Multinational National Enterprises that have FDI already in place.

(b) Monopolistic Advantage Theory

The monopolistic advantage theory by Stephen H. Hymer 1976 suggests that the MNE possesses a monopolistic advantage, enabling it to operate subsidiaries abroad more profitably than local competing firms can. The monopolistic advantage is the benefit resulted from a firm that maintains a monopolistic power in the market. Such advantages are specific to the investing firm rather than to the location of its production. Stephen H. Hymer discovered that FDI takes place because powerful MNE's choose industries or markets in which they have greater competitive advantages, such as technological knowledge, an adverse market not available to other firms operating in a given country. These competitive advantages are also referred to as firm-specific or ownership-specific advantages. According to this theory, monopolistic advantages result from two sources: Economies of scale and Superior knowledge. The term knowledge includes production technologies, managerial skills, industrial organization, and knowledge of the product.

(c) According to Neoclassical Theory

FDI influences income growth by increasing the amount of capital per person. It stimulates long-run growth through such variables as research and development and human capital.

Through technology transfer to their affiliates and technological spillover to unaffiliated firms in host economies, the MNCs can speed up the development of new intermediate product varieties, to raise product quality to facilitate international collaboration on research and development and introduce new a form of human capital according to Ikara 2003. In the Neoclassical growth models, FDI promotes economic growth by increasing the volume of investment and its efficiency but apart from that FDI affects growth only in the short run because o diminishing returns to capital in the long run. Long-run growth in the neoclassical models arises fromthe external growth of the labor force and exogenous technological progress.

3.Research Methodology

The research design for this study was exploratory because, with this research problem, there are fewer studies to refer to as to reveal the impacts which FDI had to determine the growth of Tanzania economy from 1998 to 2018. The study area in which this study was undertaken was Tanzania as to being one of the developing countries found in East Africa, to the nature of this study as an exploratory study, from sources like World Bank, IMF, Bank ofTanzania, and TIC. Thus, the method which was used to collect those data was the content analysis method. Content- analysis consists of analyzing the contents from the documentary materials such as books, magazines, newspapers, and the contents of all other verbal materials which can be either spoken or printed.

In line with similar studies on FDI and economic growth, especially across countries, the study uses a linear regression approach to determine the impact and relationship that foreign direct investment has on Tanzania's economic growth. Looking at FDI (By sector) and economic development. The statistical methods used include the Ordinary Lowest Square Method (OLS) and the Unit Root Test.

This effect/ impact was assessed using a multiple linear regression model consisting of three independent variables; FDI inflows in Manufacturing, FDI inflows in Agriculture, and FDI inflows in Mining and Quarrying sectors (inflows was measured in US$) and one dependent variable which is Growth will be measured by GDP.

From the above multiple linear regression modal, the following equation summarizes the empirical model for investigating the potential impact that FDI by sector might have on Tanzania ‘s economic growth.

$$Growth = \beta o + \beta 1 Capital + \beta 2 Labor + \beta 3 FDI.Mf + \beta 4 FDI.Mq + \beta 5 FDI.Agr + U$$

Where Growth= Economic growth of a country measured by GDP

Capital = Gross fixed capital formation percentage of GDP
Labor = Labor force total
$FDI.Mf$ = FDI inflows in the Manufacturing Sector
$FDI.Mq$ = FDI inflows in Mining and Quarrying Sector
$FDI.Agr$ = FDI inflows in the Agriculture sector

βo= Y Intercept, which is the value of Growth when$\beta 1$,$\beta 2$, $\beta 3$,$\beta 4$and $\beta 5$ = 0
$\beta 1$ = The effect of capital on growth when other factors are held fixed.
$\beta 2$ = The effect of labor on growth when other factors are held fixed.
$\beta 3$ = The effect of FDI.Mf on growth when other factors are held fixed.
($\beta 4$) = The effect of FDI.Mq on growth when other factors are held fixed.
$\beta 5$ =. The effect of FDI.Agr on growth when other factors are held fixed.
U = The Error term which accounts for other unobserved factors that may affect Growth

4. Data Analysis

The data were analyzed using STATA econometrics software. The researcher used a time series data from 1998 to 2018 in this analysis. In line with these similar studies on FDI and economic growth especially across countries, the study uses a linear regression approach in determining the influence and relationship which Foreign Direct Investment has on Tanzania ‘s economic growth. It was to look at FDI (By sector) and economic growth.

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Table 4.1: Descriptive Statistics for the Variables Used in the Analysis

Variable	**Obs**	**Mean**	**Std. Dev.**	**Min**	**Max**
Growth (%)	20	6.659533	.8704619	4.8404	7.8283
Capital (% of GDP)	20	26.41707	8.486963	16.3547	41.9314
Labor	20	19900000	2396032	16300000	23500000
FDI.mq (USD Millions)	20	330.236	297.0627	6.58	909.9
FDI.mf (USD Millions)	20	206.512	150.9501	64.21	563.8
FDI.Agr(USD Millions)	20	14.21333	6.569395	4.7	31.4

From table 4.1 above the findings show that GDP growth reveals an impressive pattern with a smaller standard deviation of 0.87 which reflects normal distribution. The range between maximum and minimum is also small where the maximum GDP growth is 7.83%. the same was attained in the year 2004. The maximum growth can be linked to the increased FDI in all sectors under the study except for the Agricultural sector in which FDI had declined previously. This is because, the findings show that the maximum FDI in the mining and quarrying sector is USD 909.9 Million, in the manufacturing sector is USD 563.8 Million while in the agriculture sector, the maximum FDI is USD 31.4 Million. Thus, the rate of FDI inflows is higher in the mining sector followed by the manufacturing sector while the agriculture sector receives little inflow of FDI as compared to other selected sectors. Considering that the sector receives low FDI, it is obvious that the mining sector leads to increasing economic growth, followed bythe manufacturing sector while the agriculture sector has a little contribution to the economic growth of the country.

5. Conclusion

Concerningthe findings in chapter four above, it can be concluded that Foreign Direct Investment in the Mining and Quarrying sectors studied has a positive effect on economic growth while Manufacturing and Agriculture has a strong, but marginal, impact on Tanzania's economic growth.

Unlike the manufacturing sector, the reason for this marginal impact may be quite lower FDI inflow in the agricultural sector.

6. Suggestions on the direction for future study

The research we were conducting at the time included only the three main FDI sectors. The study could be expanded to include other important sectors such as Housing, Information, and Communication, Manufacturing, Real Estate, Skilled, Transport and Storage, and Education. Capital or labor can also be considered intermediate to know whether they affect production. Future studies should show the extent to which FDI flow in these sectors and the extent to which they affect production and overall economic growth of the country. This will lead to the general conclusion on the sectors which contribute highly to the country's economy as a result of FDI and those which have little FDI inflow and little contribution to the economy of the country.

A similar analysis may also be carried out in other countries where their primary economic activities are exports and imports of products and services, but with Retail Trade as an independent variable and development as a dependent variable included.

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