ASSESSMENT OF THE IMPACT OF FOREIGN DIRECT INVESTMENTON ECONOMIC GROWTH IN TANZANIA: EVIDENCE FROM THE MANUFACTURING SECTOR

ASSESSMENT OF THE IMPACT OF FOREIGN DIRECT INVESTMENTON ECONOMIC GROWTH IN TANZANIA: EVIDENCE FROM THE MANUFACTURING SECTOR

By

Dorica Kabigiza

A Research Report Submitted in Partial/ Fulfillment of the Requirements for Award of Master of Business Administration Corporate Management (MBA- CM) of Mzumbe University

2014

CERTIFICATION

We, the undersigned, certify that we have read and here by recommend for acceptance by the Mzumbe University, a research report entitled **Assessment of the impact of Foreign Direct Investment on economic growth: Evidence from the manufacturing sector,** in fulfillment of the requirements for award of the Masters degree of Commerce in Accounting and Finance at Mzumbe University.

Signature here

_____

Major Supervisor

Signature here

_____

Internal Examiner

Accepted for the Board of……

Signature here

_____

DEAN/DIRECTOR, FACULTY/DIRECTORATE/BOARD

DECLARATION
AND
COPYRIGHT

I, Dorica Kabigiza, declare that, this report is my own work and that it has not been presented and will not be presented to any other university for a similar or any other degree award.

Signature……

Date…….

ACKNOWLEDGEMENT

I am indebted to all parties that sponsored, contributed or participated in one way or another in this work. I am mostly thankful to God who gave me strength, power of reasoning, supportive family, friends and good health. All this work could not be possible without the Grace of God.

With all my heart I am so thankful to my parents Mr. and Mrs. Kabigiza and all my family for the support they offered me from the beginning of this work to the end. Special thanks to Miss Felister Tibamanya and all my friends who supported and encouraged me for all the work I did to this research report.

I would like to extend my sincerely gratitude to Mr. James Mtika and Mr. Joshua Mwakalikamo for their help, corporation, encouragement, and moral support to me.

I am highly indebted to express my special and sincere thanks and appreciation and to my report supervisor Mr. Nicholous Tutuba a lecturer at Mzumbe University for his intellectual inspiration, guidance and valuable comment to this study. He endured my disturbances since the early stage of this study till the end of my work. By his help this work was successfully accomplished.

It is not possible to mention everyone by name therefore all I can say is that I give my special thanks to all the people who by any means have contributed to the success of this report.

DEDICATION

Firstly, I dedicate this work to my lovely Father Mr. Fidelis Kabigiza and mother Mrs. Christina Kabigiza for they have given me all the support I needed to ensure this research is completed successfully.

Secondly, I wish to express gratitude by dedicating this research to my supervisor Mr. Nicholous Tutuba. His close supervision and guidance throughout the research period was the key to success of this report.

The work is also dedicated to my lovely family, friends and Layne Drilling Company whose cooperation was of paramount importance in completion of my Masters degree and this report.

ABBREVIATIONS

FDI	-	Foreign Direct Investment
GDP	-	Gross Domestic Product
B.O.T	-	Bank of Tanzania
ERP	-	Economic Recovery Program
I.M.F	-	International Monetary Fund
UN	-	United Nations
WIR	-	World Investment Report
MNEs	-	Multi-National Enterprise
SOEs	-	State Owned Enterprise
TIC	-	Tanzania Investment Centre
NBS	-	National Bureau of Statistics
CPI	-	Consumer Price Index
UNCTAD	-	United Nation Centre of Trade and Development

ABSTRACT

Foreign Direct Investment (FDI) is one of the most striking features of the global economy today. This study aimed at assessing the impact of Foreign Direct Investment and inflation to the economic growth of Tanzania. The data for this research was collected from World Investment Reports; the analysis was just based time series data for the year 1980-2012. The data was transformed into logarithmic form and Unit root test was performed to ensure stationarity of the data before further analysis.

From the analysis the study found out that FDI has a significant contribution to the economic growth in Tanzania the results found out that the more FDI the more the economic growth. When FDI increases by 1 million USD, the GDP will increase by 0.396519 million USD other factors remaining constant. This could imply that an increase in FDI inflows is good to economic growth.

This study also found out that an increase in the general price level (inflation) is not a good factor for sustainable economic growth in Tanzania. From the results an increase in the general price level (inflation rate) by 1% results in a decrease of GDP 0.0351896 million USD other factors remaining constant. This implies that an increase in the general price level is harmful to economic growth.

The Study recommended that it is important for the government to of Tanzania to review investment policies that will enable FDI inflows to continue having positive impact to the local economy in Tanzania. It is also important for the government to focus on maintaining inflation at a low rate (single digit). Stability in inflation rate is an important factor to the economy, it is important for Tanzania to take into account of all factors which cause an increase in the general price levels and address them with the appropriate policies.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE
BACKGROUND INFORMATION

1.0 Introduction

Foreign Direct Investment (FDI) is one of the recently identified new important forces of globalization. The rapid growth and performance of FDI has generated a number of policy issues regarding benefits and costs to the economies of both home and host countries. At the macroeconomic level, FDI is believed to bring new capital for investment, contributing to the balance of payments, adding to the country's capital stock, and potentially adding to future economic growth. However, there are various costs associated with FDI as well. Among the costs include those related to countries competing for FDI, market failures in the investment process and the possible divergences between foreign companies and national interests.

The aim of this study will be to assess the impact of FDI and inflation rate on economic growth in Tanzania. This chapter provides the background information which highlights historical background of the problem, statement of the problem which opens up the problem under study, main and specific objectives of the study, methodology of the study and finally significance of the study.

1.1 Background of the study

Foreign direct investment (FDI) has become to be known as one of the most effective method of drawing external sources. Foreign Direct Investment is often seen as a drive for economic development as it may bring capital, technology, management know how, employment and access to new market. Policy makers have therefore tended to emphasize the benefits that FDI can bring to host economies, particularly in developing countries. Many governments have developed policies to encourage FDI.

Developing countries are conscious of development opportunities associated with private capital inflow, hence many have increasingly put in place the environment necessary for attracting foreign private capital flows, such as liberalizing their economies, adopting appropriate macroeconomic policy framework by improving infrastructure and public service delivery, controlling inflation and addressing government issues. For developing countries, the positive impact of foreign direct investment is becoming increasingly popular as a tool for economic growth and strengthening (Muhammad2007). The most strongest positives of implementing FDI is the increase in aggregate productivity, increased opportunities of employment, greater outflow of exports and exchange of technological advancement between the investor and country. Having foreign direct Investment in a Developing country enables employment, exploitation of natural and human resources, to implement innovative businesses practices, in terms of management and marketing, and facilitates in reduction of budget deficit. Another benefit of FDI is that it does involve the risks and regulations of external debt and adds value to the human capital through provision of on the job training. For countries that face a scarcity of capital and technological expertise usually experience growth slower than those that do. According to a number of studies, FDI can serve as a means of transfer of technology and knowledge (Dunning &Hamdani 1997).

Many countries strive to attract foreign direct investment (FDI) hoping that knowledge brought by multinationals will spill over to domestic industries and increase their productivity. Todaro (1994) notes that the primary factors which stimulate economic growth are investments that improve the quality of existing physical and human resources, that increase the quantity of these same productive resources and that raise the productivity of all or specific resources through invention, innovation and technological progress. FDI contributes to GDP growth rates and is seen as a vital tool for economic progress

Tanzania as one of the developing countries is also aware of developing opportunities associated with FDI. Significant measures have been taken to liberalize the Tanzanian economy along market lines and encourage both foreign and domestic private investment. Beginning in 1986, the Government of Tanzania embarked on an adjustment program to dismantle the socialist (Ujamaa) economic controls and encourage more active participation of the private sector in the economy. The program included a comprehensive package of policies which reduced the budget deficit and improved monetary control, substantially depreciated the overvalued exchange rate, liberalized the trade regime, removed most price controls, eased restrictions on the marketing of food crops, freed interest rates, and initiated a restructuring of the financial sector

Tanzania has put many efforts on attracting FDI and various reforms, these reforms include The Economic Recovery Program (ERP) established by National investment promotion Policy in February 1990, which enacted National Investment Promotion and Protection Act no. 10 of Economic liberalization toward market-oriented economy, which initiates market oriented investment code in June 1990. This was a deliberate effort to attract both local and foreign private investors by opening up the economy.

According to the World Investment Report (WIR) 2012.Tanzania took a lead in attracting FDI in the East Africa region during the past one year attracting the record of 1.1 billion. The same report has highlighted that between June 2011 and June 2012, Tanzania overtook Kenya the region biggest economy indicating the high confidence among foreign investors in Tanzania. Moreover, the report shows that for the past three years Tanzania has attracted over 47% of all flows in five East African Countries. The President of Tanzania has himself led several delegations to potential investors across the globe with the aim to brand Tanzania and its vast opportunities.

1.2 Historical Overview of FDIS in Tanzania

According to The World Economic Forum's Africa Competitiveness Report 2000-2001, published in conjunction with the Harvard Institute for International Development has top-ranked Tanzania, in a survey of African nations' efforts to improve economic and investment conditions out of twenty-four countries on its index for the correction of initial economic conditions in recent years. The report also ranked Tanzania number two after Nigeria in the African continent for optimism for future growth. It is however important to note that despite the progress made FDI is still in its relative infancy stage in Tanzania. It is still a relatively new concept in this country, which had a socialist orientation until in the recent past.

When Tanzania attained independence in 1961, political power was restored but like many other African countries during these periods, the command of the economy remained in the hands of foreign and a few Tanzanian investors. Early intention of the government to attract FDIs was shown in 1963. Foreign Investment Act was passed in order to persuade FDIs in the newly independent Tanganyika – the then name of mainland Tanzania before the 1964 union with the island of Zanzibar (Green, 1982). This became a source of differences in political opinions and dissatisfaction that eventually gave the post-independence government the impetus to announce the Arusha Declaration in 1967. The Arusha Declaration pronounced a socialist policy that was to be followed by the country. The ministerial order under the industrial (Acquisition) Act Number 5 of 1967 required all MNEs operating in the country as well as big private businesses owned by Tanzanians in Mainland Tanzania to make the government of Tanzania majority shareholder of such companies. The majority of the MNEs and big local companies operating in Tanzania were nationalized. The public corporation Act 17 of 1969 was created to put all nationalized companies under the government control and management (Ngowi, 2002).

There were minimal FDI activities taking place in Tanzania between 1970 and 1985. The majority of the investments were made by the State directly or indirectly. By 1980 there were about 400 public owned corporations and companies in form of State Owned Enterprises (SOEs). The majority of these were owned by the Tanzanian government with 100 per cent shares. The revival of the foreign investment attraction came in 1985 when, among other things, Tanzania found that it could not cope with the ailing and ill-managed public enterprises and companies. Deliberate economic liberalization policies were initiated and implemented. Reforms in financial institutions, public sector, civil service and other areas were made and are still underway to fine-tune the attraction of FDIs in the country. A law was passed in 1997 in order to promote local and foreign investments in the country. (National Investment Act 1997).

FDI inflows into Tanzania have been increasing over time. The increased inflow can be attributed to, inter alia, the major and far-reaching reforms that Tanzania has been taking in the management of its economy mainly from the mid-1980s. BoT, NBS and TIC (2001:9) point out that the monetary value of the FDI inflow into Tanzania increased sixteen-fold from US$ 47 million in 1990 to US$ 768 million by 2000. This is an increase by 15.3% over a decade or an average of 1.53% annual increase. Since mid-1980s a great deal of rules and regulations and institutions have been made or created to govern the proper functioning of private sector led market economy in the country. These efforts have resulted into an increase in foreign private investment (FPI) in Tanzania, particularly foreign direct investment (BOT, TIC, NBS, and ZIPA, 2006). The role of FDI has been widely recognized as growth-enhancing factor in the developing countries. Driven by this, government of Tanzania has attempted to attract FDI in the 1990s and have offered generous incentives to achieve this target. The Tanzania government's goal of attracting FDI was particularly motivated by low domestic savings rates accompanied by inefficient financial intermediation, which hampered their strategies to finance growth. The

other motivation behind Tanzania FDI was the opportunity to benefit from the direct and indirect effects of FDI on increasing demand for labor.

1.3 Inflation Trends in Tanzania

To attain sustainable economic growth coupled with price stability continues to be the central objective of macroeconomic policies for most countries in the world today. Among others the emphasis given to price stability in conduct of monetary policy is with a view to promoting sustainable economic growth as well as strengthening the purchasing power of the domestic currency (Umaru and Zubairu, 2012).

One of the central objectives of macroeconomic policies in Tanzania is to promote economic growth and to keep inflation at a low level Inflation rate refers to a general rise in prices measured against a standard level of purchasing power. It is a piece of economic data, usually of macroeconomic scale, that is used by investors to interpret current or future investment possibilities and judge the overall health of an economy The most well-known measures of Inflation are the CPI which measures consumer prices, and the GDP deflator, which measures inflation in the whole of the domestic economy (http://www.tradingeconomics.com) The changes in inflation rate can have adverse impact towards the economy of Tanzania. Inflation can lead to changes in exchange rates, food prices, cost of housing, transport costs

The inflation rate in Tanzania was recorded at 17.4 percent in June of 2012. Historically, from 1999 until 2012, Tanzania Inflation Rate averaged 7.4 Percent reaching an all-time high of 19.8 Percent in December of 2011 and a record low of 3.4 Percent in February of 2003. The inflation rate in Tanzania was recorded at 6 percent in February of 2014. Inflation Rate in Tanzania is reported by the National Bureau of Statistics (NBS) - Tanzania. Inflation Rate in Tanzania averaged 7.67 Percent from 1999 until 2014, reaching an all-time high of 19.80 Percent in December of 2011 and a record low of 3.40 Percent in January of 2003. In Tanzania,

the National Consumer Price Index (NCPI) measures the change over time in the cost of a fixed basket of goods and services that are purchased by a representative sample of households. The index weights are based on expenditures of both urban and rural households in the 21 geographic regions.

1.4 Statement of the Problem

All the countries in the world are continuously striving for rapid economic growth and as a result they are inviting more and more investments by allowing foreign investors to invest in their land. There are several factors that help or hinder the economic growth of a country, and the factors, that are often identified as stimulants (World Investment Report UNCTAD, 1994) for a country's growth are: (1) Large amounts of investment capital, (2) Advanced Technologies, (3) Highly skilled labor, (4) Well-developed transportation and communication infrastructure, (5) Stable and supportive political and social institutions, (6) Low tax rates, and (7) Favorable regulatory environment. Differences in the growth rates of the countries are explained by the differences in the endowments or levels of these factors (Dondeti and Mohanty, 2007).

Foreign Direct Investments (FDIs) have grown and continue to grow as well as playing significant roles in growth and development of many economies in the world by contributing to the Gross Domestic Products (GDP). FDI is now defined as not only a simple transfer of money but as a mixture of financial and intangible assets (Hill and Athukorala 1998). It is widely believed that economic growth depends critically on both domestic and foreign investments (Andenyangtso, 2005). FDI can affect the economic growth directly or indirectly. Among the expected benefit of FDI in the host economies include that of achieving social-economic transformations and poverty reduction in general. The benefits from FDIs however may differ from one country to another and from time to time depending on the prevailing social, political, economical and technological situation as well as on the legal and regulatory framework on the ground.

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. Thus, 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.

1.5 Objectives of the study

1.5.1 Main Objective of the Study

The overall objective was to know the potential impact of Foreign Direct Investment on economic growth (GDP).

1.5.2 Specific objectives

- To determine the factor that influences the gross domestic product.
- To examine the relationship between independent variables (Foreign Direct Investment, and inflation rate) with the dependent variable (Gross Domestic Product).
- To investigate the main factors that contributes towards Gross Domestic Product.

1.6 Research Questions

- How significant is the impact of foreign direct investment to the gross domestic product in Tanzania?
- Is there a significant relationship between inflation rate and gross domestic product in Tanzania?
- What is the relationship between foreign direct investment and inflation rate with the gross domestic product?

1.7 Significance of the Study

The purpose of the study was to provide more knowledge on the impact of foreign direct investment and Inflation rate on economic growth. By doing this research, the

researcher gets more exposure, experience and knowledge on how to conduct a proper research in the academic field the study can be added to the faculty and library. The outcomes of the study can be used for future references for other students. In addition, this research might help the other students to gather information and references. The students are able to use this study as additional readings apart from textbooks and lectures. To government the findings of this study can be the references to the government to know the direction of economy of Tanzania by giving evidence of how FDI and Inflation can influence the Gross Domestic Product (GDP). This study will give insight of measures to be taken to improve FDI in Tanzania by considering its impact on the GDP and Inflation. The purpose was to have the broad understanding impact of foreign direct investment to the economic growth of Tanzania.

1.8 The scope of the study

This research investigated the importance foreign direct investment and inflation rate towards economic growth. The scope of this study was between 1980 to 2012.Economic growth can be affected by different variables however this research was limited to assess the impact of foreign direct investment on economic growth in Tanzania taking into consideration of only two independent variables (FDI and Inflation)

1.9 . Limitations of the Study

In carrying this research study, the researcher was limited to funds (as it was self-sponsored) as well as validity and reliability of data sometimes time series secondary data are not accurate and they differ from one institution to another.

1.10 Delimitations of the Study

The data required was collected from already published documents hence it was easy to get access of this data and the researcher did not have to endure the problem of preparing questionnaires and interviews and it helped to save time.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

In this chapter a detailed literature review on Foreign Direct Investment and Economic growth was given. This chapter presented the main concepts to be discussed, theoretical and empirical literature that aimed at developing an understanding on the Impact of Foreign Direct Investments on Economic growth in Tanzania with evidence from the manufacturing sector.

2.1 Concept of Economic Growth

Economic growth is the increase of per capita gross domestic product (GDP) or other measure of aggregate income. Economic growth is concerned with the long run. The business cycle is the short-run variation of economic growth.

Economic growth is the increase in the market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP. Of more importance is the growth of the ratio of GDP to population (GDP per capita), which is also called per capita income. An increase in per capita income is referred to as intensive growth. GDP (http://en.wikipedia.org)

Growth is usually calculated in real terms i.e., inflation-adjusted terms to eliminate the distorting effect of inflation on the price of goods produced. In economics, economic growth or economic growth theory typically refers to growth of potential output, i.e., production at full employment. (ibid) Economic growth is an increase in the production and consumption of goods and services. It entails increasing population and/or per capita consumption. It is indicated by increasing gross domestic product (GDP). Economic growth literally refers to an economy that is getting bigger, not necessarily one that is getting better

Tanzania's economy has been growing steadily for the past 10 years. In 2012, the economy expanded by 6.9%, which is close to its more recent historical average. Most top business leaders believe that the economy is performing better in 2013 than in 2012 and are positive about the prospects for 2014, as revealed by a recent World Bank/KPMG survey.

The rapid and stable growth of the Tanzania's economy over the past few years, in spite of turbulence in world and regional markets, is explained by three factors. First, five crucial sectors have been expanding rapidly, with these five sectors driving almost 60% of growth in gross domestic product (GDP) since 2008. These sectors include the communications sector, whose contribution to GDP has doubled since 2008. The growth of this sector has transformed how Tanzanians trade and do business by facilitating a revolution in banking.

2.2 Concept of FDI

Bjorvatn (2000) defines FDI as an investment made to acquire a lasting interest in a foreign enterprise with the purpose of having an effective voice in its management. Buckley (2000) defines foreign direct investment (FDI) as a term used to denote the acquisition abroad of physical assets, such as plant and equipment, with operational control ultimately residing with the parent company in the home country. FDI may take different forms such as the establishment of new enterprises in an overseas country either as a subsidiary or branch, the expansion of overseas branch or subsidiary and the acquisition of overseas business enterprise or its assets. FDI differs from foreign portfolio investment where a stake is taken in an overseas business without operational control, but with the view to acquiring an investment income stream through dividends, capital gains and so on. FDI is furthermore, defined as a situation where a foreign company create a subsidiary to provide goods and services. Thus, a firm undertakes FDI in a foreign market if it possessed an ownership advantage over the local competitors. The ownership of the foreign investment usually remains in the investing (home) country. FDI represents the

primary means of transfer of private capital (i.e. physical or financial), technology personnel and access to the brand names and marketing advantage (Makola, 2003).

2.3 Types of FDI

There are two types of FDI, which can be clarified as, Horizontal Foreign Direct Investment and Vertical Foreign Direct Investment, which takes two forms.

2.3.1 Horizontal FDI

This is the type of investment in which multinational company carries the same industry operation abroad as a firm operates in at home. It refers to foreign manufacturing of products and services roughly similar to those the firm produces in its home market. Horizontal FDI is also known as market seeking where investment aim is penetrating new market or manufacturing existing ones but it is essentially driven by size and market growth of the host economies though even infrastructure, human capital, openness to trade, exchange rate, inflation rate, GDP growth rate do determine their flow (Lim 2001) According to Campos and Kinoshita (2003) most of global FDI is horizontal. This type of FDI is called "horizontal" because the multinational duplicates the same activities in different countries. Horizontal FDI arises because it is too costly to serve the foreign market by exports due to transportation costs or trade barriers.

2.3.2 Vertical FDI

Vertical FDI refers to those multinationals that fragment production process geographically. Vertical FDIs, is undertaken to exploit lower production costs in order to serve both foreign and home market. In this case FDI can be a complementary to trade when a part of the production in the host economy is exported back to the home country. Campos and Kishonoti (2003) say that it is also known as resource seeking FDI where investors seek to acquire factors of production that are more efficient than those obtained are in the home economy of the firm. It is

called “vertical” because MNE separates the production chain vertically by outsourcing some production stages abroad.

Vertical FDI consists of two forms, backward and forward vertical FDI.4 backward vertical FDI: where an industry abroad provides inputs for a firm's domestic production process In case of backward FDI multinational enterprise establishes its own supplier of input goods, which delivers inputs to the parent company. The objective of backward FDI has been to provide imputes into the firms downstream operation (likangaga 2010).

The second form is forward vertical FDI: in which an industry abroad sells the outputs of a firm's domestic production processes. Forward vertical FDI is less common than backward FDI (Likangaga 2010)

2.4 FDI Inflows in Tanzania

Tanzania during the pre-reforms period attracted very little FDI as compared to the neighboring countries like Kenya. For example during these period, FDI inflows in Tanzania averaged about USD 4.4 million as compared to the Kenya’s USD 32 million. In fact, among the three East African countries Kenya had an established role as the leading destination of FDI before 1990 because of her nonrestrictive policies towards the foreign investors. From 1970 until 1990 the East African countries received some USD757 million of total inflows, 90 percent of which went to Kenya, nearly 10 percent went to Tanzania, while Uganda hardly received any at all (UNCTAD, 2002).

FDI in East Africa have been increasing over time. BOT et al (2001:9) point out that monetary value of the FDI inflow into Tanzania increased sixteen-fold from US$ 47 million in 1990 to US$ 768 million by 2000. This is an increase by 15.3% over a decade or an average of 1.53% annual increase. There has been an increase in FDI stocks in Tanzania from 1985 to 1990. Tanzania under Julius Nyerere attempted a

socialist transformation that saw widespread nationalization of property, including the seizure of foreign assets. Foreign investment was legally and effectively banned. This was widened in the 1970s to include most Asian-owned businesses and an (unevenly enforced) expropriation of any property valued at greater than $15,000. Capitalism and foreign capital in particular were considered UN African, whereas *ujamaa* was considered more "authentic" and appropriate. More recently, the climate has changed considerably. Economic reforms began slowly in 1986, and accelerated after an economic crisis in the mid 1990s, substantially altering the government's stance on foreign investment.

The opening of Tanzania economy to FDI in Mid 1980's led to a rapid increase in FDI inflows. According to Tanzania Investment Centre (TIC), a total of 854 FDI projects were approved in Tanzania between 1990 and September 2000. The latest available Tanzania investment Report (BoT, NBS and TIC, 2009: vii) informs that the stock of FDI increased persistently from USD 4,438.7 million in 2005 to USD 6,239.9 million in 2008. This is an increase of40.6% during the period under consideration. According to IMF (2011), the value of FDI in Tanzania (net, current US$) was $433,441,900.

The increase of FDI inflow from 1996 is both in absolute terms and in relation to other countries, including Kenya. The increased inflows can be attributed to, inter alia, the far –reaching reforms that Tanzania has been undertaking and still at the midst of mainly from the mid-1980s (Ngowi, 2002). The privatization program, which included many nationalized firms previously owned by foreign companies, facilitated the return of foreign firms back into the country. Mining reforms in the early 1990s allowed major new investment by foreign firms, especially Ghana's Ashanti Goldfields and South Africa's AngloGold. Foreign banks were allowed entry after 1993 and several large South African and British banks began operations soon thereafter. Legal changes in 1997 lifted most of the remaining restrictions on foreign investment on the mainland (although many regulations remain in place in

semi-autonomous Zanzibar). Previous demands of government equity have also been lifted for all sectors, except for petroleum (UNCTAD, 2002).

The Citizen, citing UNCTAD (2011) informs that although there is a decline of FDIs in Africa since the global economic crisis, Tanzania has recorded an 8.5% increase of FDIs in 2010. The inflow of the FDIs in Tanzania increased from $645 million in 2009 to $700 million in 2010.

According to the World Investment Report 2013 by the United Nations Conference on Trade and Development (UNCTAD), which examines trends in Foreign Direct Investment (FDI) flows, Tanzania registered significant increase in FDIs in 2012. According to the report the flow to Tanzania increased by 38.77% between 2011 and 2012 from USD 1229.4 million to USD 1,706.0 million. This growth was driven by primary sectors particularly oil and gas exploration, with FDI contributing more than 38% to Tanzania's economy. (http://www.tanzaniainvest.com)

Tanzania's history of political stability has encouraged Foreign Direct Investment. Government has committed itself to improve the investment climate including redrawing tax codes, floating the exchange rate, licensing foreign banks, and creating an investment promotion center to cut red tape. Tanzania has mineral resources and a largely untapped tourism sector, which might make it a viable market for foreign investment.

2.5 FDI in Tanzania's Economy

Developing countries are increasingly aware of the role of foreign direct investment as an engine of growth in their economies. Foreign investors can contribute to growth by providing much needed capital and skills, by sharing risks in large projects and by serving as a vehicle for technology transfer. For many developing countries, FDI is a mechanism by which to promote industries in which they have a potential comparative advantage that cannot otherwise be exploited The most

strongest positives of implementing FDI is that it helps to increase aggregate productivity, increase opportunities of employment, greater outflow of exports and exchange of technological advancement between the investor and country.(http://www.ingentaconnect.com)

Tanzania has strived to attract foreign direct investment (FDI) hoping that knowledge brought by multinationals will spill over to domestic industries and increase their productivity. According to the Tanzania Investment Report (2004), FDI holds the largest share of the foreign private capital flows, which also include foreign portfolio investment and long and short term loans. In 2001, for example FDI stock contributed about 88.6 percent of foreign private capital stock. This shows that FDI is an important foreign investment in the Tanzania's economy. As regards FDI components, direct equity investment forms an important component of FDI in Tanzania contributing about 76.3 percent of FDI stock in2001.

2.5.1 Sector Distribution of FDI

In Tanzania more than 25% of the TIC registered projects are owned by foreign affiliates/companies that have operations in Tanzania in sectors such as agriculture, manufacturing, tourism, telecommunication, services, petroleum and mining just to mention a few. Its impact to the local economy has been in terms of job creation, government revenue, transfer of technology and skills, capital invested and foreign exchange earnings.

The largest sector for FDI is believed to be the manufacturing sector with about 33.5percent of total FDI stock by 2001, while the second largest sector for FDI is believed to be mining with about 28 percent of total FDI stock by the same year. Much of the FDI in the manufacturing sector went to food and beverages, while in the mining sector; the largest single sub-sector in terms of FDI has been the gold mining industry. Tanzania's ability to attract mineral explorations and investment has been highly dependent on the country's abundance of mineral resources.

However, during 1990s this was boosted by the revised, investor-friendly investment and mining code introduced in 1998, which was well received by international investors. There has been a dramatic growth in the mining sector since the 1990s. In 1998, Tanzania was the leading country in Africa in terms of the number of exploration activities above traditional mining countries of South Africa and Ghana.

While there is a high concentration of FDI into the manufacturing and mining sector, it should be noted that Tanzanian economy depends heavily on agriculture, which accounts for more than 25% of GDP, provides 85% of exports, and employs 80% of the work force. This is a challenge for the government to attract foreign investors who may have competitive advantage in the sector. Currently the government of Tanzania has put more emphasis on agriculture and there is increasing number of foreign and domestic private investments in the agricultural sector. The Gross Domestic Product (GDP) in Tanzania expanded 6.50 percent in the third quarter of 2013 over the same quarter of the previous year. GDP Annual Growth Rate in Tanzania is reported by the National Bureau of Statistics (NBS) - Tanzania. GDP Annual Growth Rate in Tanzania averaged 7 Percent from 2002 until 2013, reaching an all time high of 11.20 Percent in the fourth quarter of 2007 and a record low of 2.90 Percent in the fourth quarter of 2006. In Tanzania, the annual growth rate in GDP measures the change in the value of the goods and services produced by the country economy during the period of a year of the Tanzania's economy contributing.

Tanzania continues to do well in maintaining overall macroeconomic stability which, along with

Institutional and policy reforms, has been a fundamental factor behind the strong economic growth rates. Agricultural growth must be accelerated to achieve more effective poverty reduction. Investment effort in Tanzania is still too low and a lot of improvements are still needed to make investment work for its development

(Investment policy in Tanzania, 1997). The business environment could be further boosted by heightening Tanzania's attractiveness to local and foreign investors through strengthening its human resource base and reinforcing overall institutional capacity and efficiency. The newly found natural gas resources could provide impetus for future development. The main drivers of growth have been agriculture, manufacturing, wholesale and retail trade, transport and communication activities. The economy has also continued to record strong export growth. Tanzania's medium-term growth prospects are around 7%, significantly boosted by natural gas discoveries which have attracted more investors to come and invest in Tanzania.

2.6 Concept of inflation rate

Inflation rate is a measure of inflation. It is also as the rate of increase of a price index for consumer price index. Inflation is a rise in consumer prices and increasing the cost of living. It is also the percentage rate of change in price level over time. The inflation rate is one of the most important economic forces consistently weighing on the value of a nation's currency.

Some inflation is caused because a country has printed too much money or experienced tremendous financial disaster, causing its currency to plummet. Other sources of inflation can be higher input or transportation costs such as gas, which makes it more expensive to ship good to the store. When the pressures get too great, retailers often pass these costs on to consumers.

There are five types of inflation. There are demand pull inflation, cost push theory, money supply, effects of inflation and deflation.

2.7 Theoretical Literature Review

2.7.1 Theories of FDI

(a) Product Life-Cycle Theory

This was developed by Raymond Vernon in 1966 it was used to explain certain types of FDI made by U.S companies in west Europe after the second World War in the

manufacturing industry. Vernon believes that there are four stages of production cycle: 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 in order serve the foreign market (Eden and Miller 2004). To understand foreign direct investment must first understand the basic motivations that cause a firm to invest abroad rather than export or outsource production to national firms. The purpose of this International product life-cycle theory provides a theoretical explanation for both trade and FDI. Vernon's theory is more relevant to manufacturers' initial entries into foreign markets than to MNEs that have FDI already in place.

(b) Internationalization Theory

The theory tries to explain the growth of transnational companies and their motivation for achieving Foreign Direct Investment. The theory was developed by Buckley and Casson in 1976 they demonstrated that transnational companies are organizing their internal activities so as to develop specific advantages

According to this theory, it is important to understand the role an entrepreneur plays a part in explaining the international riding activities of a nation. Given that an economy may comprise several industries accommodating an array of firms, it appears reasonable that the role of decision makers within such organizations can, collectively, provide a substantial contribution to economic performance. In contrast to the international trade and other FDI theories, internationalization theories Endeavour to explain how and why the firm engages in overseas activities and, in particular, how the dynamic nature of such behavior can be conceptualized.

(C) Monopolistic Advantage Theory

The monopolistic advantage theory by Stephen H.Hymer 1976 suggests that the MNE possesses monopolistic advantages, enabling it to operate subsidiaries abroad more profitably than local competing firms can.

Monopolistic advantage is the benefit accrued to 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 found that FDI takes place because powerful MNEs choose industries or markets in which they have greater competitive advantages, such as technological knowledge 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 come from two sources: superior knowledge and economies of scale. The term knowledge includes production technologies, managerial skills, industrial organization, and knowledge of product.

(d) According to Neoclassical Theory

FDI influences income growth by increasing the amount of capital per person. It spurs long-run growth through such variables as research and development and human capital. Through technology transfer to their affiliates and technological spill over to unaffiliated firms in host economies MNCs can speed up the development of new intermediate product varieties , raise product quality facilitate international collaboration on research and development and introduce new form of human capital (Ikara 2003) In the neoclassical growth models FDI promotes economic growth by increasing The volume of investment and/or its efficiency but 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 from exogenous growth of the labor force and exogenous technological progress

(e) According to the Endogenous growth model.

In the endogenous growth models FDI raises growth through technological diffusion from the developed countries to the developing. This permanent knowledge transfer from FDI accounts for the diminishing returns that result in long run growth. The endogenous growth literature has identified country conditions that must be present for FDI. To have a positive impact on growth such as the complementarily between

domestic and foreign investment, adequate levels of human capital, open trade regimes, and well developed financial markets. Li and Liu (2005)

2.8 Empirical Literature Review

The majority of this research work will be done in the perspective view of Tanzania. Some of the important empirical studies will be critically reviewed to develop objectives in the context of Tanzania and they will further analyzed to draw some important conclusions and recommendations. Various studies on the subject of inflation, Foreign Direct Investment and Economic growth have been presented.

According to *Chee-KeongChoong and Kian-Ping Lim (2008),* there are positive relationship between foreign direct investment and economic growth and between financial development and economic growth both in short and long run. The finding also highlights the importance of Malaysian absorptive capacity in transferring the benefits embodied in foreign direct investments inflows into higher economic growth.

According to *Shu-Chen Chang (2010),* the foreign direct investment inflow has a positive effect on economic growth. Foreign direct investment influences economic growth directly but does not influence economic growth indirectly through crowding in domestic investment. In addition, two unidirectional causalities running from economic growth to domestic capital and from domestic capital to foreign direct investments are found in Taiwan.

According to *Dennis E. Logue and Richard James Sweeney (1981),* there is positive relationship between the mean inflation rate and the variability of real economic growth. A number of considerations suggest a positive relationship between higher average rates of inflation and greater variability (or uncertainty) of inflation, which in turn leads to greater uncertainty in production, investment, and marketing decisions and greater variability in real growth.

According to *Barro (1991), Fischer (1993), Bullard and Keating (1995)*, they found that there exists a negative relationship between inflation and economic growth.

According to Ram and Zhang (2002), FDI provides ready access to the world markets and acts as a conduit for the host country to participate in the globalization process. Using co-integration and an error-correction model to examine the link between FDI and economic growth in India, Ram and Zhang(2002) also discussed some points which supports the notion that FDI promotes growth: (1) FDI provides the financial resources needed by the host country, (2) FDI acts as a vehicle for the transfer of advanced manufacturing technologies from the DCs(Developed countries) to the LDCs(less Developed countries), (3) FDI increases competition in the host country's markets, (4) FDI helps the host countries improve their foreign exchange reserves (or balance-of-payments position)by increasing exports, (5) FDI brings along with it the management know-how needed to run the facilities, (6) FDI enhances the training and employment opportunities for the people of the host country, (7) FDI reduces the burden of imports on the host countries through import substitution, (8) FDI acts as catalyst for increasing domestic savings and investment. In general, FDI provides ready access to the world markets and acts as a conduit for the host country to participate in the globalization process

The World Investment Report UNCTAD (1999) also describes some econometric models for determining the impact of FDI on growth. After analyzing the data from 11 countries in East Asia and Latin America, using econometric techniques such as unit root and co integration tests they provides evidence that FDI promotes economic growth in countries with a liberalized trade regime, and a workforce with higher job skills and education.

Bengoa et al. (2003) found that FDI affects growth positively. In order for a positive effect from FDI to be achieved, the country must have an adequate level of human capital, economic stability, and liberalized capital markets.

Mubarik (2005) found that low and stable inflation promotes economic growth and vice versa. Also the study carried by Shitundu and Luvanda, (2000) on the effect of inflation on economic growth in Tanzania concluded that inflation has been harmful to economic growth in Tanzania but they did not show the degree of responsiveness of GDP growth rate to changes in the general price levels. This study examined the impact of inflation on economic growth in Tanzania by showing the degree of responsiveness of change in GDP due to change in general price levels in Tanzania and thus filling the existing knowledge gap.

Chakrabory and Nunnenkamp (2008) analyzed sector growth impact of FDI in case of India and found that FDI in the service sector appears to have promoted growth in the manufacturing sector through cross-sector spillovers and thus economic growth.

Falki (2009) conducted a study on the impact that FDI had on the economic development of Pakistan. The study included data on FDI gathered from the Handbook of Pakistan economy of 2005. Data ranged from 1980 and 2006 and held variables such as domestic variables, labor force and foreign invested capital. Falki used the endogenous theory of growth and a regression analysis, Falki was able to conclude that FDI had statistically negative effect on the gross domestic product and foreign direct investment in the country.

Adam & Tweneboah (2009), economists from Ghana, conducted an independent study on the FDI and stock market development in the country concludes that FDI in Ghana had a positive impact on the development of the economy and the stock market. The examination included data of market capitalization as a proportion of the Local GDP and Ghana cedi and Dollar exchange and the net FDI influx of the quarters between the years 1991 to 2006. With the use of multivariate co-integration analysis and the Vector Error Correction Model., the study revealed that the relationship between FDI and the Ghanaian stock market will be beneficial in the long run for the country.

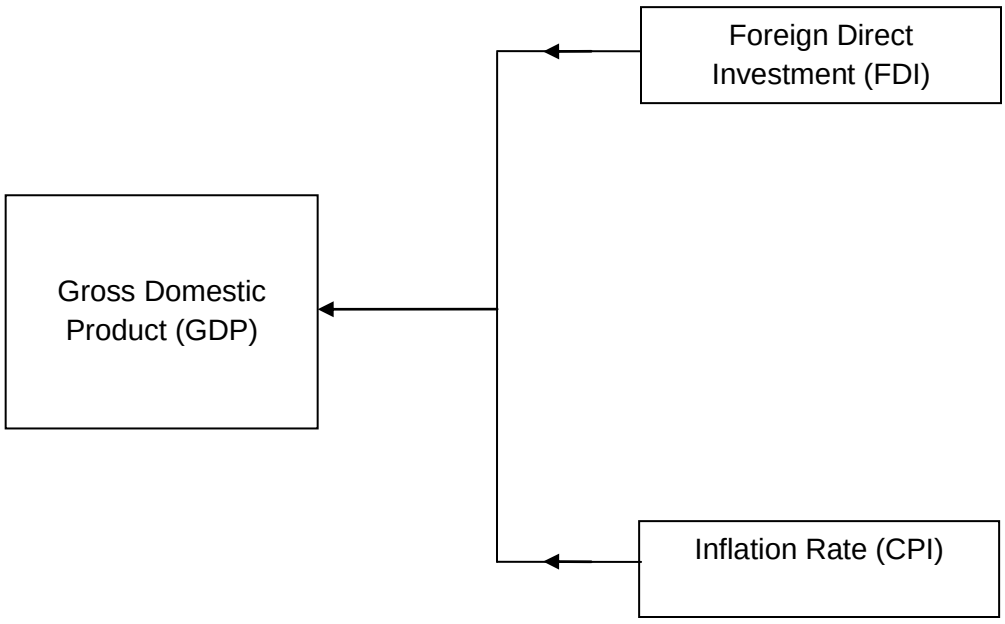
From the above empirical reviews it can be noted that rapid growth and performance of FDI has generated a number of policy issues regarding benefits and costs to the economies of both home and host countries. FDI is believed to bring new capital for investment, contributing to the balance of payments, adding to the country's capital stock, and potentially adding to future economic growth. FDI is also cited as a more stable type of capital flow, and thus is arguably more appropriate and development-friendly for low-income countries than portfolio flows. There is also some evidence that foreign investment can contribute to raising exports and integrating into global economic networks.

2.9 Theoretical Framework

The Theoretical framework employed in this study will be based on the relationship between Foreign Direct Investment (FDI) and Inflation rate and their impact on economic growth (GDP) in Tanzania. The model will be composed of two independent variables namely FDI (Foreign Direct Investment) and Inflation (CPI) and one dependent variable Gross Domestic Product (GDP).

FIGURE 2.1. THEORETICAL FRAMEWORK

DEPENDENT VARIABLE **INDEPENDENT VARIABLES**



***Source**: Researchers own design, 2014*

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines the methods and procedures, which were used by the researcher in the study. It includes the choice of a research design, sampling techniques and data collection techniques. Due to the fact that impact of FDI and Inflation on economic growth cannot be measured accurately and these two independent variables represents a complex package of attributes that vary over time, methodology will be based secondary data collection, data analysis and data presentation will be done in order to meet the research objectives.

3.1 Study Design

This was a statistical comparative study design, the data used were secondary time series data from documented publications and other Documentary Reviews, the rationale of using secondary data in this study was to save time and money and use the information obtained in triangulating the findings from the study.

This study wanted to test the impact of FDI and Inflation on economic growth in Tanzania. The samples use in this study was time series data from year 1980 until 2012.

3.2 Sample size and Sampling technique

The method used to collect the sample was purposive sampling technique. The purpose was to analyze the data from previous years for FDI and Inflation and to see how the impact the economic growth. The number in the sample consisted of 33 year of, foreign direct investment and inflation rate and GDP The selection criterion was based on the availability of the data in DataStream of Tanzania Investment Reports and UNCTAD.

3.3 Study Area

In this research, the researcher wanted to investigate relationship between dependent variable (gross domestic product) and independent variables, foreign direct investment and inflation rate. The study was centered on Tanzania by analyzing the data from year 1980 to 2012 in view on the manufacturing sector.

3.4 Data Collection

Given the nature of this study only secondary data from public sources were used. For FDI inflows GDP and Inflation trends data was obtained from official publications reports and other documentary reviews from World Investment Reports of UNCTAD, Bank of Tanzania (BOT) and National Bureau of Statistics (NBS), IMF, also books, journals and internet. The period under study ranged from 1980-2012. These sources are published every year and gives information related to FDI and Inflation Rate and GDP.

3.5 Data Analysis and Presentation

The obtained data was coded, edited and analyzed with quantitative techniques with the purpose of getting a meaningful relationship between variables. The data available was analyze by regression analysis. In statistic, regression analysis includes any techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent and independent variables. In analyzing the data collected, the researcher will be use the STATA and Microsoft excel programs to analyze this research to find the best results. Tables and diagrams were also used to present information for easy understanding.

3.6 Data Processing Procedure

In order to test the effect of variable and estimation Linear Multiple Regression model was used. The general purpose of linear multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent or criterion variable. When using multiple regressions in psychology,

many researchers use the term “independent variables” to identify those variables that they think will influence some other “dependent variable”. In this case FDI and Inflation were our independent variable, whereas GDP was the dependent variables.

The model was expressed as:

$GDP = \beta 0 + \beta 1\ (FDI) + \beta 2\ (CPI) + \varepsilon$

Whereas:-

GPD= Gross Domestic Product at a particular time

FDI= Foreign Direct Investment at a particular time

CPI= Inflation rate level at a particular time

β0= Represents Slope of Regression

β1 and β2= Represents coefficient of regression

3.7 Hypothesis Testing

Alternate hypothesis is a statement that expressing a relationship between two variables or indicating differences between groups. Based on the framework, researcher was able to develop hypothesis namely null hypothesis (H_0) and alternate hypothesis (H_1) in relation with the dependent variable and the independent variables as

HYPOTHESIS 1

H_0: There is no significant relationship between Foreign Direct Investment and Gross Domestic Product. H_1: There is a significant relationship between Foreign Direct Investment and Gross Domestic product.

HYPOTHESIS 2

H_0: There is no significant relationship between Inflation rate and Gross domestic product.

H_1: There is a significant relationship between inflation rate and Gross domestic product.

HYPOTHESIS 3

H_0: There is no significant relationship between foreign direct investment and inflation rate and gross domestic product.

H_1: There is a significant relationship between foreign direct investment and inflation rate and gross domestic product.

3.8 Estimation Technique

In order to estimate the model STATA was used to analyze the relationship between Foreign Direct Investment (FDI), Inflation and their impact on Economic growth in Tanzania. FDI and inflation were our independent variable, GDP was our dependent variables.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.0 Introduction

Under this chapter presents the estimated results and data analysis on the impact of foreign Direct Investment on Economic growth in Tanzania. The Analysis followed the objectives mentioned above. The focus on the analysis was on the two independent variables (FDI and Inflation) and their impact on one dependant variable (GDP). Data analysis involved logical interpretation, comparison and explanations of the estimated results for the years 1980-2012.

4.1 Estimated model

The linear multiple Regression model was used to learn more about the relationship between FDI, Inflation and GDP of Tanzania

GDP= f (FDI, CPI)

FDI and CPI (inflation) were considered to be the function of GDP

$GDP = \beta 0 + \beta 1\ (FDI) + \beta 2\ (CPI) + \varepsilon$ ……..…….. (1)

4.2 Variable Transformation

In order to be able to test for stationarity of the variables from our model, and in order to avoid misspecification it was decided to transform variables before conducting a unit root test (stationary test for time series data). All the three variables in our model (GDP, FDI and Inflation) were transformed in logarithmic form.

The Transformed model was;

$\ln GDP = \beta 0 + \beta 1\ \ln(FDI) + \beta 2\ \ln(CPI) + \varepsilon$ ……(2)

4.3 Unit Root test for stationary of data

Literatures show that using non stationary time series data could yield meaningless results. The major purpose for conducting unit root test is that if we use the data without checking their stationarity trend, the results derived from the regression models would produce the so called spurious results (Datta and Kumar, 2011). Before estimating our modified model in the equation (2) it was very important to test out stationarity and trends of the variables to be estimated. The stationarity test was done using the Augmented Dickey-Fuller (ADF) unit root test before the study proceeded with the estimation of the model in equation (2). With the ADF test you may optionally exclude the constant, include a trend term, and include lagged values of the difference of the variable in the regression, this means that the unit root problem can be eliminated or stationarity can be achieved by differencing the data set.

4.3.1 ADF unit root test for lnGDP and trend for GDP

(a) ADF test for GDP

Table 4.1. Augmented Dickey- Fuller results for lnGDP

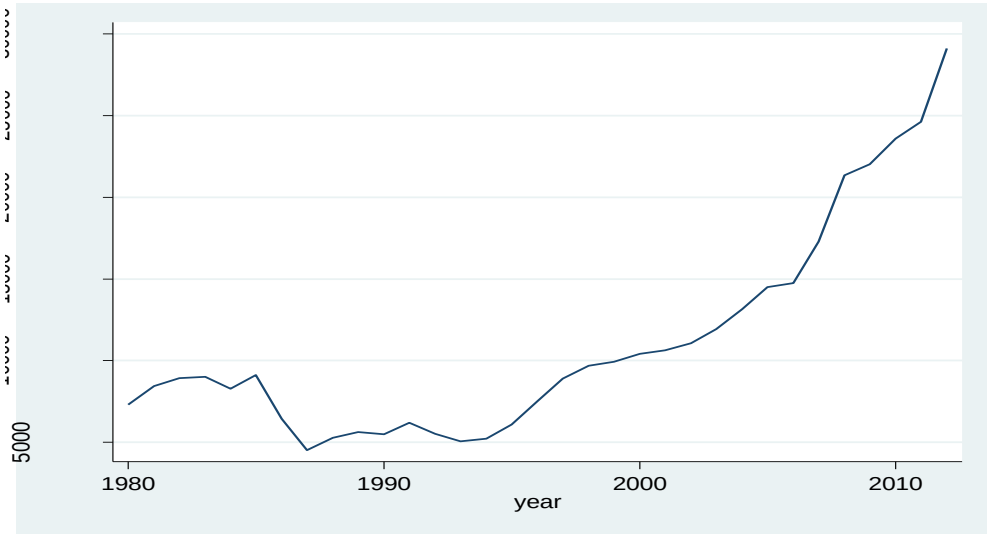
```
. dfuller lngdppercapital, noconstant lags(0)

Dickey-Fuller test for unit root                    Number of obs   =        32

                                 ------------ Interpolated Dickey-Fuller ------------
                    Test         1% Critical       5% Critical      10% Critical
                 Statistic           Value             Value            Value
------------------------------------------------------------------------------
     Z(t)          1.912             -2.649            -1.950           -1.603
```

***Source**: Research findings, 2014*

Results: from table 4.1 show GDP is stationary at the level that has no constant term lag (0) since our test statistic computed Z(t) exceeds the DF Z(t) at in absolute terms at the critical value of 10%. |1.912|>|-1.603| hence we reject the null hypothesis and accept the alternative hypothesis that our GDP variable is stationary hence can be used for further estimations.

(b) GPD trends

Figure 4.1 GDP trends for years 1980-2012



Source: *research findings, 2014*

From figure 4.1 we can observe that the GDP of Tanzania of Tanzania was declined from mid 1980s and it began to pick up in mid 1990s this is due to privatization which was introduced in early 1990s as the result the general utilization and industrialization rose leading to more investment and promoting GDP. From mid 1990s the trend show constant rise to 2012.

4.3.2 ADF unit root test for lnFDI inflows and trend for FDI inflows

(a) ADF unit root test for lnFDI

Table 4.2. Augmented Dickey- Fuller results for in FDI inflows

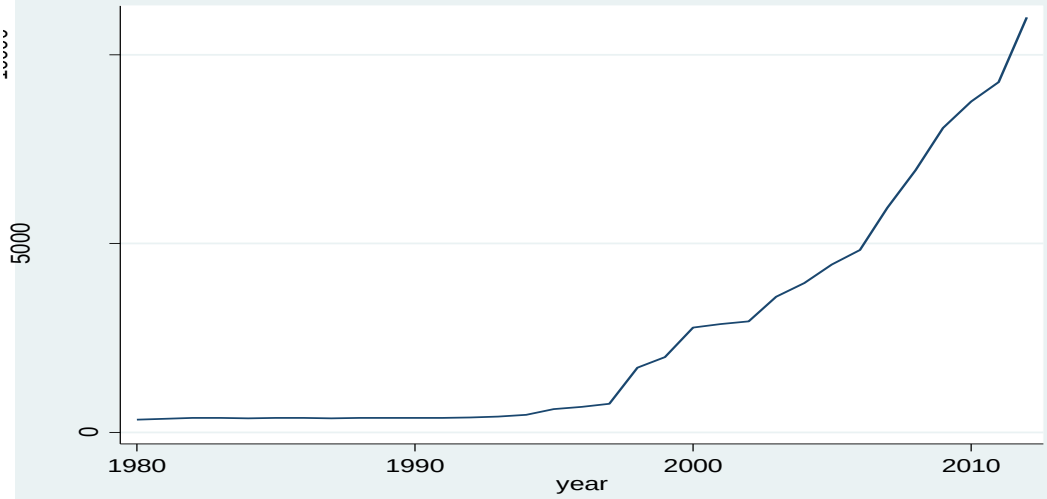
```
. dfuller lnfdiinflows, noconstant lags(0)

Dickey-Fuller test for unit root                   Number of obs   =        32

                                 ---------- Interpolated Dickey-Fuller ---------
                    Test         1% Critical       5% Critical      10% Critical
                 Statistic           Value             Value            Value
------------------------------------------------------------------------------
 Z(t)              4.174            -2.649            -1.950           -1.603
```

Source: *Research finding, 2014*

Results: from table 4.2 show FDI is stationary at the level that has no constant term lag (0) since our computed Z(t) exceeds the DF Z(t) at in absolute terms at the critical value of 1%, |4.174|>|-2.649| hence we reject the null hypothesis and accept the alternative hypothesis that our FDI variable is stationary hence can be used for further estimations.

(b) FDI inflows trend

Figure 4.2 FDI inflows trend 1980-2012



Source*: Research findings, 2014*

FDI where constant from 1980to the early 1990s when the government launched a programs designed to restructure and privatize the publicly owned enterprises. As a result, the general utilization of the installed industrial capacities rose.FDI flows into Tanzania was very minimal and they remained below USD 200 million almost for the entire 1990s. However, the flows increased rapidly from 2000 whereby they accelerated to more than USD 1,000 million in 2011 (see Figure 4.2). This increase is due to concerted efforts by the Government which include reforms on trade, exchange rate, monetary policies, promotion of private investment, good

governance, improved infrastructure and social services which have contributed to favorable investment environment in the country.

WIR (2012) shows that during the past 1 year Tanzania took the lead in attracting FDI in the East African region, attracting the record of $1.1 billion equivalent to (TSh1.76 trillion at the exchange rate of Tsh1,600 per USD1.00).

4.3.3 ADF unit root test for lnInflation inflows and trend for Inflation rate

(a) ADF unit root test for lnInflation

Table 4.3. Augmented Dickey- Fuller results for lnInflation

```
. dfuller lninflation, drift lags(3)

Augmented Dickey-Fuller test for unit root         Number of obs   =        29
```

	Test Statistic	Z(t) has t-distribution 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-1.448	-2.492	-1.711	-1.318

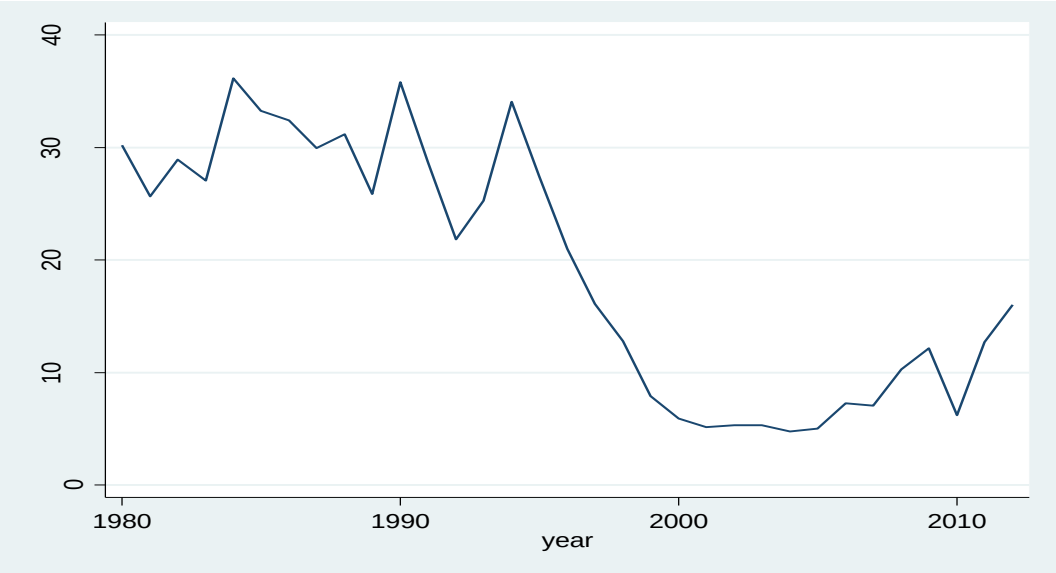
p-value for Z(t) = 0.0803

Source: *Research findings, 2014*

Results: table 4.3. above show Inflation rate is stationary at the level that include drift terms lag (3) since our computed Z(t) exceeds the DF Z(t) at in absolute terms at the critical value of 10%, |-1.448|>|-1.318| hence we reject the null hypothesis and accept the alternative hypothesis that our Inflation variable is stationary hence can be used for further estimations.

(b) Inflation rate trend

Figure 4.3 Inflation trend 1980-2012



Source: *Research findings, 2014*

The inflation trend in Tanzania has been fluctuating and the trend as a lot of double digit inflation rates. The fluctuating inflation rate in Tanzania is contributed by seasonal food crops, whereby the inflation rate for food and non alcoholic beverages increase more than other goods. From late 1990s to 2010 there has been a steady and decline of Inflation. This could have been the result of a combination of the implementation of stricter monetary policy and a decline in food and energy prices. According to the WIR (2012), the decline in Inflation has also contributed to the stabilization of the real exchange rate, which appreciated by almost 20% in 2011/12 as the result of the large inflation differential between Tanzania and its trade partner. This stabilization of the real exchange rate also has positive implications for exporters.

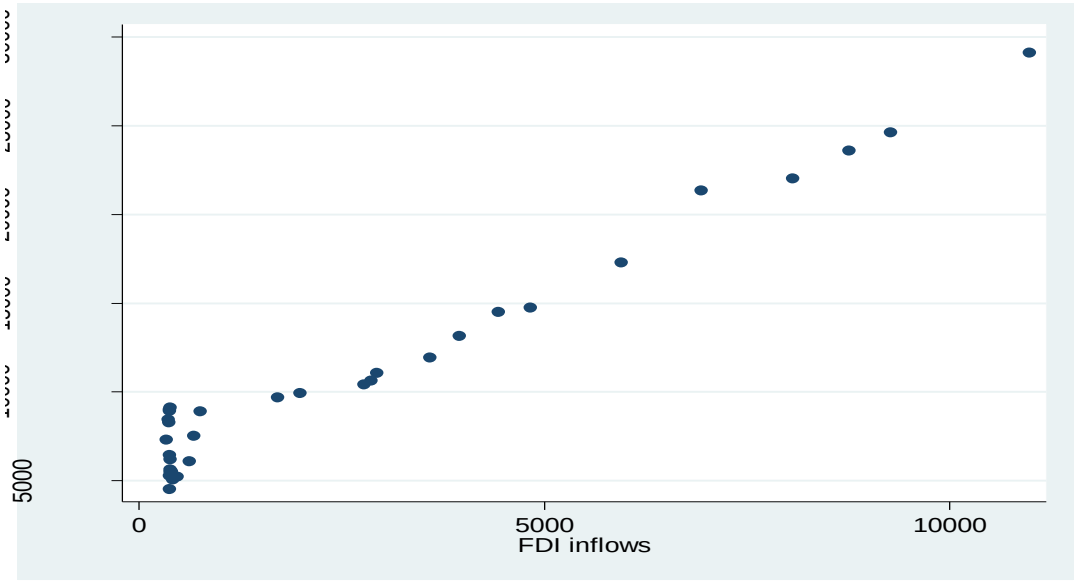
4.4 Test for Linearity

Linearity assumes that the relationship between dependent and independent variables is linear, or they perform better if the relationships are linear. If a relationship is nonlinear, the statistics which assume it is linear will underestimate the strength of

the relationship, or fail to detect the existence of a relationship. Linearity means that the amount of change or rate of change, between two variables is constant for the entire range for the variables.

There should liner relationship between Independent Variables and Dependent Variable. The linear relationship between GDP with each independent variable was analyzed by using the scatter plot which are used to show the relationship between two variables as follows

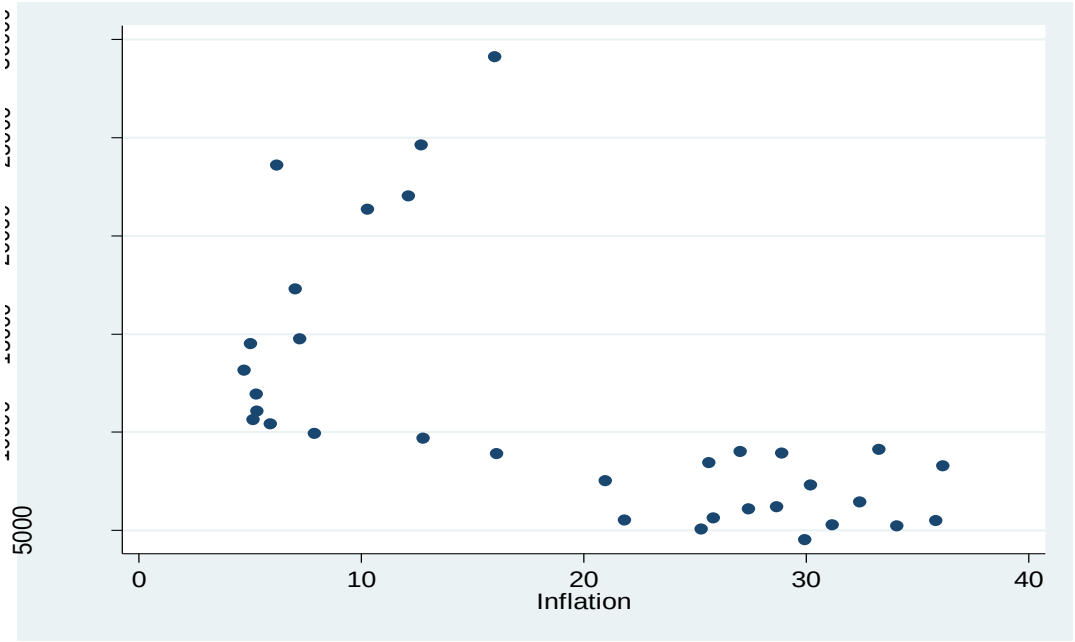
Figure: 4.4 Scatter plot for – GDP and FDI



***Source**: Research findings, 2014*

From the above scattered plot we see there is a positive linear relationship between GDP and FDI. This does not violate the assumption of linearity.

Figure 4.5: Scatter plot for GDP and Inflation



From the above diagram we can see there is a curve non liner relationship between GDP and Inflation this violates the assumption of linearity. Hence Inflation does not perform better against GDP.

4.5 Test for Hetoroscedasticity

Test for Hetoroscedasticity was performed to determine if the problem existed in regression analysis, heteroscedasticity means a situation in which the variance of the dependent variable varies across the data. Heteroscedasticity complicates analysis because many methods in regression analysis are based on an assumption of equal variance. The hypothesis for Hetoroscedasticity is as follows

H0: there is no constant variance of residuals (hetoroscedasticity)

H1: variance of residuals is constant (no hetoroscedasticity)

Table 4.4. Test for Heteroscedasticity

. hettest
Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Variables: fitted values of lngdppercapital
chi2(1) = 1.69
Prob > chi2 = 0.1942

Source: *Research findings, 2014*

The results indicate that there is no heteroscedasticity because Prob>chi2 is 0.1942 which is greater than 10% level of significance. Therefore we reject the null hypothesis and we accept the alternative hypothesis therefore the variance of our residuals is constant therefore our assumption has been satisfied.

4.6 Test for Multicollinearity

Multicollinearity occurs when there is a linear relationship among one or more of the independent variables. In the case we have two independent variables (FDI and Inflation). When we have multicollinearity problem the inclusion of the two independent variables in our model becomes problematic for estimation. Intuitively, a problem arises because the inclusion of both adds no more information to the model than the inclusion of just one of them. It is the undesirable situation where the correlations among the independent variables are strong.

The VIF (Variance Inflation Factor) statistical test was used to test if there was a problem of multicollinearity. VIF measures how much the variance of the regression coefficients is inflated by multicollinearity problems. If VIF equals 0, there is no correlation between the independent measures. VIF measure of 1 is an indication of some association between predictor variables, but generally not enough to cause problems. A maximum acceptable VIF value would be 5.0; anything higher would indicate a problem with multicollinearity.

Table 4.5 Test for Multicollinearity

```
. vif
    Variable |      VIF      1/VIF
-------------+----------------------
  lninflation |
          D3. |     1.00    0.998942
lnfdiinflows |     1.00    0.998942
-------------+----------------------
    Mean VIF |     1.00
```

Source: *Research findings, 2014*

From the results the VIF is 1.00 this indicates that there is some association between our two independent variables but not enough to cause the problem of multicollinearity because our VIF does not exceed 5.0. Therefore the results show that there is no problem of heteroscedastisity.

4.7 Interpretation of the time series regression results

A multiple linear Regression model was used to assess the impact of FDI and Inflation on Economic growth in Tanzania. Time series data for 33 years of FDI, Inflation and GDP were observed from different authorities (BOT, TIC and UNECTAD). The estimation results after transformation of variables and testing for stationarity are shown in the table below

Table 4.6 Regression results

variables		Number of obs. = 30 F(2, 27) =92,93 Prob>F = 0.0000 R-squared = 0.8732 95% Confidence interval	
ln gdp	**Coef**	**t**	**P> |t|**
ln FDI inflows	.396519	13.59	0.000
ln inflation D3	-.0351896	-0.69	0.497
Cons	6.318202	29.42	0.000

Source: *Research findings, 2014*

- **Specific Interpretation of the results**

From the regression results the estimated model is

lnGDP = 6.318202 +0.396519ln FDI -0.0351896lnInflation + ε

The results indicate that

- Other factors being constant the level of GDP will be 6.318202 million USD.
- There was positive relationship between FDI and economic growth in Tanzanian economy in the period of study When FDI increases by 1 million USD, the GDP will increase by 0.396519 million USD other factors remaining constant. This could imply that an increase in FDI inflows was good to economic growth.
- The results showed that there was negative relationship between inflation and economic growth in Tanzanian economy in the period of study. This means that an increase in the general price level (inflation rate) by 1% results in a decrease of GDP 0.0351896 million USD other factors remaining constant. This could imply that an increase in the general price level was harmful to economic growth.

- **Model evaluation**

The level of significance is 0.05 (5%)

From our regression results

P (f) =0.0000

Condition P (f) < 0.05

If the condition is met it indicates that there is power of the independent variables (FDI and Inflation) in explaining the dependant variable (GDP). This means the P (f) value is statistically significant

From the results 0.000 < 0.05, therefore the model is accurate to explain variation of GDP by FDI and Inflation because P (f) is less than the level of significance (0.05)

The R square measure is used to test the goodness-of-fit of the model which indicate the amount of variation in the dependent variable explained by the model. The model is well fit to explain the variation of the dependent variable (GDP) by the independent variables (FDI and Inflation) because R-square is 0.8732 equivalents to 87.32%. This indicates that the regression results make sense and our model is statistically significant.

4.8 Hypothesis Testing

Hypothesis testing, tests of significance, and confidence intervals which indicates if there is or there is no relationship between the two variables, therefore we test null hypothesis and alternative hypothesis. If we use the t-test according to the rule if t-c > t-tabulated we reject null hypothesis and accept alternative

HYPOTHESIS 1

H_0: There is no significant relationship between Foreign Direct Investment and Gross Domestic Product.

H_1: There is a significant relationship between Foreign Direct Investment and Gross Domestic product.

From the table above table t calculated that explains the relationship between FDI and GDP is (13.59) and t- tabulated from the distribution table is 1.697 at level of significance of 0.05

t- Calculated > t-tabulated (13.59 > 1.697)

Therefore we reject the null hypothesis and accept alternative hypothesis hence there is a significant relationship between foreign Direct Investment and gross domestic product.

HYPOTHESIS 2

H_0: There is no significant relationship between Inflation and Gross Domestic Product.

H_1: There is a significant relationship between Inflation and Gross Domestic product.

From the table above table t calculated that explains the relationship between Inflation and GDP is (-0.69) and t- tabulated from the distribution table is 1.697 at level of significance of 0.05

t- Calculated < t-tabulated (-0.69 < 1.697) this violates the assumption.

Therefore we accept the null hypothesis and reject alternative hypothesis hence there is no significant relationship between foreign Direct Investment and gross domestic product. This is not statistically significant.

HYPOTHESIS 3

H_0: There is no significant relationship between Foreign Direct Investment, Inflation and Gross Domestic Product.

H_1: There is a significant relationship between FDI, Inflation and Gross Domestic product.

From the table above table t calculated that explains the relationship between FDI, Inflation and GDP is (29.42) and t- tabulated from the distribution table is 1.697 at level of significance of 0.05

t- Calculated < t-tabulated (29.42 < 1.697).

Therefore we reject the null hypothesis and accept alternative hypothesis hence there is A significant relationship between foreign Direct Investment, FDI and Gross Domestic product. This is statistically significant.

4.9 Discussion

From the estimated results all variables were all satisfied, that is, All variables were stationary, there was no multicollinearity and heteroskedasticity observed, implying that the estimates are reliable and therefore can be relied upon. The results from regression analysis revealed Foreign Direct Investment has a positive impact to economic growth (GDP) that means FDI contributes positively to the economy of Tanzania therefore it should be encouraged and promoted on the other hand results revealed that inflation has the negative impact on economic growth of Tanzania. This indicated that inflation is harmful to economic growth of Tanzania hence it should be controlled, Tanzania should try to maintain a single digit inflation rate because increasing inflation is harmful to the economy. From our results the estimated model was reliable.

CHAPTER FIVE

RECOMMENDATIONS AND CONCLUSION

5.0 Introduction

This study aimed at assessing the impact of Foreign Direct Investment and inflation to the economic growth of Tanzania.

From this study we observed that FDI has significantly contributed to the economic growth in Tanzania the results found out that the more FDI the more the economic growth. Therefore it is important for the government to of Tanzania to review investment policies that will enable FDI inflows to continue having positive impact to the local economy in Tanzania. FDI is an important indicator of globalization in Tanzania. Foreign companies often possess advance environmental technologies and can use them in all countries in which they operated. Foreign companies can improve competition. This can increase the welfare of consumers through the improvement of product quality, the availability of additional products in the market, the expansion of the product market and reduced prices of products. However, small producers in the host countries may suffer if they fail to cope with the competitive prices. In this case, foreign companies can crowd out local investors. Foreign companies can become important employers through the generation of new jobs in their new projects. Foreign companies may also contribute to fiscal revenue through their operation. Therefore it is important for the government of Tanzania to formulate policies which will enhance positive impact of FDI to the local economy.

This study also found out that an increase in the general price level (inflation) has not been a good factor for sustainable economic growth in Tanzania. These results have important policy implications for both domestic policy makers and development partners, implying that controlling inflation is a necessary condition for promoting economic growth. Thus, policy makers should focus on maintaining inflation at a low rate (single digit). Stability in inflation rate is an important factor from the results we can see that the inflation rate in Tanzania have negative

relationship to the economic growth in Tanzania. In this regard, the study concluded that it is important for Tanzania to take into account of all factors, which cause an increase in the general price levels such as energy crisis, exchange rates volatility, and increase in money supply, poor agricultural production and so forth and address them with the appropriate policies so as to foster economic growth.

5.1 Challenges to be taken in to consideration so as to increase benefit from FDI

Specific, long-term, successful economic policy to improve FDI in Tanzania must take into consideration of the following challenges: Unstable currency, stable, poor technology, poor infrastructure, unskilled labour, unsatisfactory investment conditions poor leadership, unsatisfactory regulatory framework, financial resources and unfavorable tax systems and corruption Another challenge is the so-called "quiet corruption," which is less visible than big-time corruption but occurs across a much wider set of transactions directly. All these challenges if not dealt with they can lead to unfavorable results of FDI in Tanzania hence they need to be dealt with appropriate policies so as to enable Tanzania to gain from FDI

5.2 Policies to attract more FDI in Tanzania

Tanzania has done a great job to promote and improve investment climate. However the challenges are still there. The Government is therefore advised to take action and reduce these challenges. Recognizing a problem is the first step to solving it.

The Government is therefore advised to take appropriate action to correct these shortcomings and attract FDI, which is desired for economic growth. Some of the researcher's suggestions include;

- Creating a better policy, administrative, legal, regulatory and judicial framework. This involves improving accessibility to the court system for formal and informal business and speeding the quality of service provided by court system for business, improvement customer service for services provided to the private sector by the public and judicial service. One of the

essentials to attract investments is to reform the public administration and to review the numerous unnecessary regulations and malpractices which often are precondition for corruption schemes. The Government of Tanzania to provide a transparent and appropriate incentive and regulatory framework to attract investors and benefit the country.

- Strengthening Leadership capacity and security. Stability of the economic environment, entry and exit barriers, transaction costs, property rights, contractual obligations, investment structure and good leadership are essential to consolidate the growth momentum of the private capital flows.
- Following the sharp increase in FDI inflows to electricity and gas, the on-going initiatives to put in place policy and regulatory framework for governing the electricity and gas activities need to be expedited in order to provide guidance and ensure adequate benefits to the country. If managed well, these gas reserves have the potential to transform Tanzania's economic future. While the most significant impacts of this discovery on the local economy will not be felt for at least seven to ten years, when exploitation will start at full scale, the discovery will nonetheless drive increased economic activity during the construction phase. In the long term, the magnitude and timing of the impact of the discovery remain uncertain. Careful management of the revenues derived from the newly discovered natural resources will be required to ensure the optimal use of these revenues and to achieve inclusiveness. (http://www.worldbank.org)
- Combating Corruption and bribery activities. For a firm, paying bribes is like paying a tax, but then the firm is faced with more uncertainty. In general. However, certainty in future operations is required for FDI in activities such as manufacturing. Corruption and conflict are important elements of political risk assessments, which in turn determine investor perceptions of the business climate in a country. Therefore it is important for Tanzania to make efforts to promote good governance and fight against corruption.

- Implementation of land law reforms and review of clause and transfer of property rights
- Devising appropriate policies and strategies for building the capacity of local firms to ensure competitiveness.
- Improve spending on critical infrastructures, Infrastructure and skills are important determinants of FDI. Surveys show that a low level of appropriate skills is one of the main barriers to investing in Africa. In addition, if there is no proper infrastructure, investors have to build their own in order to produce, transport, sell or export their products. At the same time, infrastructure and skills help to absorb the positive effects from FDI (e.g. Borensztein *et al*, 1998). It is important for Tanzania to strive and try to provide appropriate infrastructure (ports, roads water pipelines, electricity and telecommunications), with skilled labour force. With good infrastructure investment can be enhanced, local firms can more easily capture knowledge spillovers, for instance through becoming local suppliers. This is necessary also to enable investors to generate higher returns and encourage reinvestment.
- Encourage investment on agricultural sector which is the most important sector for economic growth in Tanzania. Efforts to make agriculture more attractive to investors need to be stepped up in order to boost inflows to agriculture, which have so far remained low compared to traditional recipients. Such efforts include investments in rural infrastructure, irrigation schemes, rural electrification to facilitate agro processing and the countrywide land mapping and categorization.
- The implementation of the skills localization policy need to be strengthen, for instance through establishment of skills programs that will be aligned with skills required by investors with a view to speeding up the transfer of skills to locals.

- Determine whether and how FDI fits in with development objectives. FDI is not a solution to all economic problems. However, in order to find solutions to economic issues, it is important to realize that FDI is different from local investment, external aid flows, or portfolio inflows. The existence of such differences requires that a country examines how FDI fits in with their economic objectives. For instance Tanzania has categorized various sectors for investment promotion into priority and lead sectors. It is therefore interesting to know whether there are no policy conflicts.

The government needs to continue to fight corruption and strengthen transparency and accountability across sectors and at all levels. The government has made good progress in implementing the Extractive Industries Transparency Initiative, which will be increasingly important in the context of natural gas development. Strengthening public financial management in the country, both at the central and local government levels, is essential for high quality infrastructure investments, more effective service delivery, and attracting private investment.

Policies to help regulate inflation trends in Tanzania

This study found out that an increase in the general price level (inflation) has been harmful to sustainable economic growth in Tanzania. These results have important policy implications for both domestic policy makers and development partners, implying that controlling inflation is a necessary condition for promoting economic growth. Thus, policy makers should focus on maintaining inflation at a low rate (single digit). Stability in inflation rate is an important factor.

Since the double-digit inflation rate in Tanzania is mainly due to energy crisis and poor agricultural produce, the government should use other sources of power such as gas as an alternative to hydro-electricity. Constant availability of power is of great important for production since the more the country produces the less the prices of goods and services hence higher economic growth. Similarly agricultural produce may be increased by improving infrastructure, provision of labour force, training to

farmers as well as strategies like loan provision schemes with affordable interest rates and establishment of permanent markets for their products should be undertaken. to attain and sustain high economic growth (GDP) policy makers in Tanzania should strive to keep inflation rate at a possible minimum rate.

5.3 Conclusion

This paper has attempted to establish the potential impact of FDI on economic Growth in Tanzania. However, the analysis was just based time series data for the year 1980-2012.For Tanzania to understand the impact of Foreign Direct investments and Inflation on the economy, as well as monitoring the operations of foreign investors' data availability is very important. Later in the paper, the study highlighted some key challenges t policymakers necessary for FDI to play a role in achieving country's economic growth objectives. An active policy is required to attract FDI and to make FDI work for economic growth also good policies are essential to control price fluctuation (Inflation) so as to enable the stability of our currency and promote economic growth.

REFERENCE

Adam, A. &Tweneboah, G. (2009) Foreign Direct Investment and Stock Market Developments. International Research Journal of Economics Issue, 26.3

Barro, R. (1996). Determinants of economic growth: A cross-country empirical study. NBER Working Paper Vol. 56, No. 98, pp. 22-29.

Barro, R. J. (1995) *Inflation and Economic Growth*. NBER Working Paper 5326.8.

Bjorvatn, K. (2000). FDI in LDCs: Facts, Theory and Empirical Evidence, Manuscript Norwegian School of Economics and Business Administration.

Blomstrøm, M. and Kokko, A. (1994), Home Country Effects of Foreign Direct Investment: Evidence from Sweden.Stockholm School of Economics, Economics Research Institute, Working Paper No. 3.

Chakrabory, C., and Nunnenkamp, P. (2008). *Economic Reforms, FDI, and Economic Growth in India:A Sector Level Analysis*. World Development, 36, 1192–1212. http://dx.doi.org/10.1016/j.worlddev.2007.06.014.

Datta, K. and Kumar, C. (2011). Relationship between Inflation and Economic Growth in Malaysia. International Conference on Economics and Finance Research IPEDR, Vol. 4, No. 2, pp. 415-16.

Dirk Willem te Velde (2001) Foreign Direct Investment for Development Policy challenges for Sub-Saharan African countries Research Fellow International Economic Development Group Overseas Development Institute 111 Westminster Bridge Road London SE1 7JD United Kingdom. Email:

Dondeti and Mohanty.(2007). Impact of Foreign Direct Investment on the Gross Domestic Product, Exports and Imports of Four Asian Countries.*Delhi Business Review,* 8, 3-23.

Dunning, J. &Hamdani, A. (1997) *the new globalism and developing countries* Tokyo; New York: United Nations University Press.12.

Falki, N. (2009) *Impact of Foreign Direct Investment on Economic Growth* in Pakistan,

Gujarati, N. and Porter, D. (2009). 3rd edn. Basic Econometrics. US: The McGraw-Hill.

Hansen and Rand. (2006). On the Causal Links Between FDI and Growth in Developing Countries. *The World Economy*, 29, 21-42. http://dx.doi.org/10.1111/j.1467-9701.2006.00756.x.

Hsiao and Shen. (2003). Foreign Direct Investment and Economic Growth: The Importance of Institutions and Urbanization. *Economic Development and Cultural Change,* 51, 83-896.

http://en.wikipedia.org/wiki/Economic_growth, January, 2014

http://www.afdb.org/en/countries/east-africa/tanzania/tanzania-economic-outlook/, January, 2014

http://www.indexmundi.com/tanzania/gdp_real_growth_rate.html, January, 2014

http://www.ingentaconnect.com/content/aea/aer/2004/00000094/00000003/art00011, February, 2014

http://www.sciencedirect.com/science/article/pii/S0014292198000488. January, 2014

http://www.worldbank.org/en/country/tanzania/overview

http://www.worldbank.org/en/country/tanzania/overview, January, 2014

Lim E. (2001) Determinants and the Relationship between Foreign Direct Investment and growth. IMF working paper No. WP/01/175, International Monetary Fund, Washington DC.

McGraw-Hill.www.ccsenet.org/i jbm International Journal of Business and Management Vol. 6, No. 10; October 2011 *Published by Canadian Center of Science and Education*

Mwase, N. (2006). An Empirical Investigation of the Exchange Rate Pass-Through to Inflation in Tanzania, IMF Working Paper /06/150, 4-7.

National Investment Act, (1997)

Ngowi, H. P. (2001c). "Attracting New Foreign Direct Investments in Tanzania", forthcoming in Tanzanet Journal, Issue No. 1: 2001, online at www.tanzanet.org OECD (1993). Promoting Foreign Direct Investment in Developing Countries

Pearce, R.D. (1992). The Determinants of Foreign Direct Investment: A Survey of the Evidence, United Nations, New York.

Ram and Zhang. (2002). *Foreign Direct Investment and Economic Growth*: Evidence form Cross-Country Data for the 1990s. Economic Development and Cultural Change, 51, 205-215. http://dx.doi.org/10.1086/345453.

Review of Business Research Papers Vol. 5 No. 513.

Shitundu, L. and Luvanda, G. (2000). The Effect of Inflation on Economic Growth in Tanzania, African Journal of Finance and Management, Vol. 9 No. 1, pp. 70-77.

Tanzania Investment Report.(2004) Benchmarking Tanzania's Foreign Direct Investment, Dar-es-salaam, Tanzania.

Umaru, A. and Zubairu, J. (2012). The Effect of Inflation on the Growth and Development of the Nigerian Economy: An Empirical Analysis, International Journal of Business and Social Science, Vol. 3, No. 10, pp. 187-188.

UNCTAD. (2013). *World Investment Report*

UNCTAD.(1994). *World Investment Report*.

UNCTAD.(2002). *World Investment Report*.

UNCTAD.(2011). *World Investment Report*.

Wang, J., and Blomstrom, M. (1992). Foreign investment and technology transfer: a simple model. *European Economic Review*, 36, 137-55.

Wu, J. & Chiang, H. (2008) *Does Foreign Direct Investment Promote Economic Growth?*Economics Bulletin, Vol. 15(12)

APPENDICES

APPENDIX 1

Data for GDP, FDI and Inflation for years 1980-2012 in 1000 million USD

year	Gdp per capital	FDI inflows	Inflation
1980	7,310	342	30.20
1981	8,433	361	25.65
1982	8,924	379	28.93
1983	9,002	380	27.06
1984	8,270	372	36.15
1985	9,120	386	33.28
1986	6,442	379	32.43
1987	4,514	378	29.95
1988	5,261	382	31.19
1989	5,619	388	25.85
1990	5,480	388	35.83
1991	6,194	388	28.70
1992	5,528	400	21.85
1993	5,052	420	25.28
1994	5,210	470	34.08

1995	6,076	620	27.43
1996	7,519	681	20.98
1997	8,890	760	16.09
1998	9,679	1 715	12.80
1999	9,921	1 989	7.89
2000	10,424	2 781	5.92
2001	10,637	2 867	5.15
2002	11,070	2 939	5.32
2003	11,935	3 590	5.30
2004	13,142	3 954	4.74
2005	14,492	4 439	5.03
2006	14,739	4 827	7.25
2007	17,299	5 950	7.03
2008	21,340	6 941	10.28
2009	22,034	8 066	12.14
2010	23,587	8 762	6.20
2011	24,636	9 278	12.69
2012	29,104	10 984	16.00

Source: World investment Reports, UNECTAD (1980-2012)