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The Impact of Foreign Direct Investment on Economic Development in Tanzania

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Abstract: *Foreign direct investment (FDI) inflows are seen as important catalyst for Economic growth in developing countries. The article aimed to discover and present the empirical evidence on how FDI influences economic development in Tanzania for a period 1998-2018 annual serial data. The multiple regression analysis technique was used to analyze the collected data. The result of study reveals that FDI has positive impact on the Economic development growth of Tanzania.*
The suggested model produce findings intended to find the relationship between FDI and GDP and the model tend to fit well and provide the result that FDI has influence to the decision making process when it comes to economic development in Tanzania.
Key words: FDI, ECONOMIC DEVELOPMENT

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I. Introduction

Background of the study

Tanzania is experiencing sustained economic growth, with Gross Domestic Product ("GDP") consistently growing at an average of 7% per annum for the last ten years. This is a result of economic reforms and sound economic policies that were introduced since the second half of the 1990's. The largest export contributors continue to be primary commodities, particularly gold, coffee, tea, cashew nuts and cotton. At the same time, the volume of manufactured exports has surged in recent years, with the lion's share of these exports going to markets within the region. Meanwhile, tourism is Tanzania's main foreign exchange earner. Tanzania recorded a GDP growth rate of 7.0% in the year 2015, making it among the fastest growing economies in Africa.

Tanzania has enormous investment potential in number of areas including agriculture, mining, manufacturing, transportation, tourism, education, health and infrastructure. Government is taking measures to improve investment climate and promote foreign as well as attain higher economic growth through exploitation of the available investment opportunities.

Economic growth is an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. Economic growth can be measured in nominal terms, which include inflation, or in real terms, which are adjusted for inflation. Economic growth also associated with technological changes. Gross Domestic Product is an estimated value of the total worth of a country's production and services, within its boundary, by its nationals and foreigners calculated over the course on one year. Gross National Product is an estimated value of the total worth of production and services, by citizens of a country, on its land or on foreign land in this research GDP will be used as measure for economic growth.

FDI refers to an investment in foreign country where the investors retains control over the investment. In these issues of FDI it is a long-term investment because it cannot easily seen in a short time of period in an invested sector. FDI can be by new venture or subsidiary, acquiring a stake in an existing firm or stating a joint venture in a foreign country. The share of Africa's FDI in total flows to developing countries for the past few years was 7.8% average. The inflow to the region declined from USD 52.6 billion in 2009 to USD 43.1 billion in 2010 to USD 42.7 billion in 2011. However the inflows to Sub-Saharan Africa recovered from USD 29.5 billion in 2010 to 36.9 billion in 2011. Oil industry continues to dominate FDI flows to the continent and Ghana emerged as major host country in Africa.

Foreign Direct Investment is one of many other factors that contribute on Tanzania's economic growth. The role of FDI has widely recognized as growth-enhancing factor in developing countries (Falki, 2009). Most of studies have written on how FDI has became on of the most important investment in the hosting countries and it has shown positive impact in economic growth of the countries. FDI increases the provision of funds for domestic investments, encourage the creation of new jobs, reinforce the technology transfer and increase in total economic growth (Dritsaki &stiakakis, 2014).

According to Falki, 2009FDI emerged as the important source for external source flows to developing countries over the years and has become a significant part of capital formation for these countries despite their share in global distribution of FDI continuing to remain small or even declining.

The Role of Foreign Direct Investment

FDI is the catalyst for any developing countries, FDI benefits the development of receiving countries also it accelerates the economic growth of the investors for their maximizing their income and economic enrichment.

Foreign direct investment (FDI) is a key driver of international economic integration. With the right policy framework, FDI can provide financial stability, promote economic development and enhance the well being of societies. Moosa (2002) describes FDI as the process undertaken by the country's corporations or individuals in whom they buy assets or manufacturing units in another countries to improve production process. For Wacker (2011) viewed FDI, precisely FDI, as the one of the major tools for international economy. It is used to achieve the balance development of global economy as it provides opportunities for developing and underdeveloped countries all over the world to achieve economic growth to get the desired development of the countries. Foreign direct investment offers advantage to both the investor and foreign host country. These incentives encourage both parties to engage in and allow FDI.

Silajdzic & Mehic (2015) found that FDI is assumed directly affect Economic Growth by contributing to Gross Fixed Capital formation and indirectly by contributing for knowledge stock. For the knowledge transfer, FDI has contributed relatively more to the growth than the domestic investment. The higher productivity of FDI holds only when the host country has minimum share hold stock of human capital Borensztein, De Gregorio and Lee (1998).

FDI has considered as an engine that pulls up economic development especial when engaged in good condition. Foreign capital can help reduce gape between the requirement of capital and national savings, raise skill levels in the host country and improve market access as well as contributing to transfer technology and good governance Abbes, Moste'fa, Seghir and Zakarya (2015).

FDI can interact with economies of scale, human capital, infrastructure, wage levels as well as regional differences to facilitate economic growth. Chee and Nair (2010) in their study they showed that the development of finance sector enhances the contribution of FDI on the economic growth in the region and the complementary role of FDI.

According WIR (2018) Tanzania's share in global FDI inflows remained constant at 0.1 percent during 2013-2017, while in Africa, its share averaged 3.0%. During 2017, FDI inflows to Tanzania were estimated to decline to USD 1.2 billion consistent with the global trend.

Aim of the study

The main objective of the study

- To investigate the impact of foreign direct investment and economic growth
- To investigate the association between FDI and economic growth

Research Questions

- How does FDI affect economic growth in Tanzania?
- How FDI and economic growth associate?

II. Literature Review

FDI has positive influence in developing countries

FDI has seemed to have positive influence in the developing countries in their economic development. FDI increases domestic investment which is the main factor in a country to good economic growth which have made most developing countries in Sub-Saharan countries especial Tanzania marking good strategies, rules and incentives which will attract FDI inflows. There are a lot of researchers who have done empirical studies on the relationship between FDI and Economic Growth are those of Blomström (1986), De Gregorio (1992), Mody and Wang (1997), Nair-Reichert and Weinhold (2001), and Lensink and Morrissey (2006).Mencinger (2003) has argued that many international institutions, politicians and economists generally consider FDI as a factor, which enhances host country economic growth, as well as the solution to the economic problems of developing countries.

The study by Silajdzic & Mehic (2015) found that FDI is assumed to directly affect economic growth by contributing to gross fixed formation and directly by contributing to the knowledge stock. Nistor (2014) found the positive impact of FDI on host economies, manifesting differently depending on the area and regional of FDI; its impact depends largely on the quality and quantity of the inflow.

According to Kumari (2014) FDI can fuel domestic investment in the host counties, diffuse technology, enhance competition in the local market, reduce saving and investment gape, increase employment opportunities, reduce poverty, increase efficiency and productivity, increase export, facilitate import, increase standard of living, create more competitive business environment, improves human capital formation, provide access to international market and create externalities and knowledge spill overs.

Hussain&Haque (2016) on their study revealed that there is relationship between FDI, trade and the growth rate of per capital GDP. For trade and FDI variables has significant impact on the growth rate of GDP per capital.The studies of Aziz and Mishr (2016), Mahalakshmi,Tiyagarajan and Naresh (2015) have found when exchange rate increases the economy of the certain country becomes more reliable and firm become willing to invest in that country, so they assumed that exchange rate have positive effect on FDI inflows.

FDI has negative influence in developing countries

FDI has seemed to have also negative influence in the developing countries in their economic development. However, there is also evidence that FDI is a source of negative effects as witnessed by Haddad and Harrison (1993), Grilli and Milesi- Ferretti (1995) and Javorcik (2004). However researchers like Mohamed and Sidiropoulus (2010), Blonigen and Piger (2011), Jimborean and Kelber (2014) have found the role of infrastructure is not huge attraction of FDI to dome countries.

Developing countries have taken FDI as important role which boost economic growth. A study by Gunby, Jin, and Robert Reed (2017) revealed that the effect of FDI on Chinese economic growth is much smaller than one would expect from naïve aggregation of existing estimates.

Corruption has reduced level of FDI in different countries where level of corruption is very high. Most studies have shown there is negative relationship in FDI when the country have high corruption rate.Jimborean and Kelber (2014), Bo (2009), Lucke and Eichler (2016) have concluded that the higher corruption level in the country has negative impact on FDI inflows. Studies like FanbastenEscober (2016),Goswami and Haider (2014), Kisto (2017), Naude and Krugell (2007) found that the short lasting political regime has negative influence on FDI inflows as the risk in case is too high.

Macroeconomics also plays a great role in determining for investors to invest or not. Macro economies like inflation and exchange rate can facilitate or not facilitate investment in a country. Studies, which have been made by Naude and Krugell (2007), Kisto (2017) have assumed that there is negative relationship between inflation rate and FDI inflows. Bo (2009), Sandhu and Gupta (2016), Simionescu (2017), Kisto (2017) examined the real exchange rate and found that this factor has significant but negative effect on attracting FDI.

Tanzania has been to FDI for a long time even before the union of Tanganyika and Zanzibar in 1964. FDI has been there although it was not successful in rapid way as other countries succeeded. It has been said that the policy are unpredictable, lack of FDI target, inadequate incentives to investors, delays by the government in making decision on some major projects and multiple regulatory bodies has been a big challenges for investors.

This paper aimed to find the how FDIinfluences Tanzania Economic Development and its impact in determining the Economic development of Tanzania. The strength of the study was built upon not only current data but also researcher included different readings.

III. Research Methodology

This chapter describe the methodology of research, the main data collection methods will be presented, which methods should be used to do analysis of FDI influences, what kind of variables have been used in research and how to measure that variables, what econometric model used and what result have been gained from data analysis.

Research Design

Research design can be defines as overall strategy that the researcher chooses to combine different components of study in ensuring the research problem is address effectively. It provides blueprint on collection, measurement and analysis of data towards achieving intended objectives.

The study on the impact of FDI on economic growth in Tanzania was conducted using quantitative analysis. Quantitative method will be analyzed to give empirical findings, so the testing of hypothesized predictors with FDI and economic growth is required. The secondary data were used to assess the impact of FDI on the economic growth of Tanzania. The study analyzes time series data through 1998-2018 for the following independent variables FDI, inflation rate, and exchange rate and trade openness. Data was obtained from Back of Tanzania (BOT) database given by the bank.

This research paper will conduct empirical research to discover whether FDI influences in the decision making process when it comes to economic development in Tanzania.The main purpose is to find out the relationship between dependent and independent variables, for this case we are trying to find relationship between FDI and GDP. The OLS will be used.

Source Of Data And Definitions Of Variables

In this case we will use the time series between (1998-2018) as the secondary data. The data are collected from Bank of Tanzania (BOT).

From the literature review we can notice countries GDP per Capital, GDP Growth or GDP in market price measure country's market size. The country with large market size attracts more FDIs. For the case of Tanzania we are going to test if there is any relationship between GDP and FDI inflows in the country using level of economic development.

Inflation and exchange rate has been suggested as important variables in this model. As a measure of inflation we will use annual inflation based on consumer price (%) and exchange rate annual average of Tanzania currency.

Any country with higher level of trade openness and with more connection to the world economy attracts investment easily. A country's openness is its control of the sum of import and export to GDP. If the amount of openness is higher we can expect that there will be the positive relationship with FDI.

List of variables and definition

Variables	Definition
GDP(the dependent variable)	Level of economic development
FDI (the independent variable)	Annual inflow of Tanzania FDI
Inflation rate (control variable)	Inflation, consumer prices (annual %)
Exchange rate (control variable)	Annual average exchange rate of Tanzania currency
Trade openness (control variable)	Trade % of GDP

Econometric Model

For the research, theordinaryleast square method will be used (OLS).In order to reduce the extremum, heteroscedasticity and collinearity of model variables, and to facilitate the interpretation of the coefficients of variables, logarithmic processing is conducted for all variables.

$lnGDP_t = \alpha + \beta_1 lnFDI_t + \beta_2 lnIFNL_t + \beta_3 lnEXCH_t + \beta_4 lnOPEN_t + \varepsilon_t$

Where

α = intercept

lnGDP= value of gross domestic product measured in particular time period

lnFDI = value of foreign direct investment inflow over a time

lnINFL= inflation, consumer price (annual%)

lnEXCH= exchange rate

lnOPEN= trade openness

β_i=variable coefficient and i= 1,2,3,4

t=time period factor (from 1998-2018)

ε=an error term from the model variables

The above regression model describes the impact of FDI on economic development in Tanzania.

IV. Data Analysis And Interpretation

MULTIPLE REGRATION ANALYSIS

OLS Regression Results

The R squared in the model is 0.988and the adjusted R squared is 0.985, so the model fits well.

Regression results

Variables	Control				
lnFDI	0.197***				
	(3.482)				
lnIFNL		0.049			
		(1.130)			
lnOPEN			-0.060		
			(-1.255)		
lnEXCH				0.895***	
				(16.762)	
Constant					-0.054***

(-2.980)

Note: the number in parentheses represents the value of t.*** represents that it's significant at the 1% level.
The obtained regression equation is as follows:

$lnGDP_t = -0.054 + 0.197lnFDI_t + 0.049lnIFNL_t + 0.895lnEXCH_t - 0.060lnOPEN_t + \varepsilon_t$

Warnings:
[1] Standard Errors assume that the covariance matrix of the errors is correctly specified.

The study conducted multiple regression analysis to determine the relationship between FDI and economic growth in Tanzania. The finding of the study is presented in the table below.

Model	Sum of squares	Degree of freedom	F statistics	Pro statistics
Regression	0.807	4.0	323.006	0.000
Residual	0.010	16.0		
Total	0.817	20		

Dependent variable GDP
Predictors (constants) FDI, EXCHANGE RATE, INFLATION AND TRADE OPENNES.

Descriptive data

Variables	Max	Min	Mean	Std
FDI	3336830.21	114526.67	1412648.08	1041367.16
GDP	1151440194.20	33562834.38	65852915.00	25077508.00
INFL	0.1975	0.0325	0.0757	0.0413
EXCH	2264.1384	664.6804	13268.7563	484.9447
OPEN	0.4323	0.1571	0.2749	0.0857

The finding showing that the significant value is less than 0.05 so statistically considered predicting how FDI, inflation rate, exchange rate and trade openness affect the GDP of Tanzania. The F value calculated is greater than F critical value, which shows that the overall model was significant.

V. Discussion Of The Study Findings

Tanzania is the one of Sub-Sahara countries and developing country, which in historical times used to be colonized by British and German colonies. After independence the country went ups and downs in economic changes. In recent years FDI has been seen as the factor to boost country economic development, therefore discovering the main determinants of FDI inflows in Tanzania has become most important in order to be able to make policies and reallocation of resources to increase FDI inflows in the country.

The empirical analysis has been done using factors that might be significant on how FDI influences economic development in Tanzania.

R squared is statically measure of the fit that indicates how much variation of dependent variable is explained by the independent variables in regression model and Adjusted R square compares the descriptive power of the regression model that includes the diverse number of predictors.

From this model R square is 0.988, which means the dependent variable is completely explained by independent variables and Adjusted R square is 0.985 this indicates the model fit well. It indicates that the model explain all the variability of the response data around its mean. In this model it has high R square which is almost 98.8% and this has proved the model fit well and hence FDI has great influence on economic development of Tanzania.

F statistics it indicate the significance whether the linear regression provide better fit to the data. From our model our f statistic is 323.000 and its prob (f statistic) is 0.000 that shows if the f statistic is equal to zero the model fit well so as the model has fitted.

For Regression sum of squares we check the differences between the predictable value and the mean of dependent variable. The RSS in this model is 0.807 and total sum squares TSS is 0.817 which is almost equal to SSR in our model and this implies that the regression model captured all the observation variability and its perfect as well as fits the model.

Generally, since the researcher intended to find the relationship between FDI and GDP and the model tend to fit well and provide the result that FDI has influence to the decision making process when it comes to economic development in Tanzania.

VI. Conclusion

Tanzania is small developing country which is highly relies in FDI. The FDI inflows to the country have been fluctuating from back days up to date and has been significant during years and consindering their huge role in Tanzania’s economy. This empirical study has revealed the influence of FDI to Economic

development of Tanzania during the period 1998 to 2018 Period of time, in order to make some decision-making when it comes to economic development of Tanzania.
The suggested model produce findings intended to find the relationship between FDI and GDP and the model tend to fit well and provide the result that FDI has influence to the decision making process when it comes to economic development in Tanzania.

VII. Recommendation

For the further research, we suggest conducting qualitative analysis to find out other factors that might highly influence economic development this will provide overall view of economic development in Tanzania. There are a lot of sectors contributes to economic development more than FDI.

As we conclude that diaspora play a great role in FDI inflows into the country, we suggest the government to make steps to introduce the country to the foreigner firms with the help of diaspora. In this way not only diaspora will do FDIs but also will encourage foreign MNEs to do so. Also the government of Tanzania should revise the laws regarding FDI in order to benefit more than weak laws which may lead to loose of revenue but at the same time should check ways more to attract FDI inflows in the country.

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