



FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH IN KENYA

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Abstract: Economic growth in Kenya has been fluctuating over the years, but it has generally decreased gradually but significantly. The fluctuating and at times decreasing economic growth is denying Kenya an opportunity to create more jobs, reduce poverty and attract investments. This study therefore sought to investigate the effect of foreign direct investment on economic growth in Kenya. This study used an explanatory research design. The study was conducted in Kenya and sampling was done along the years. The study used secondary time series data from the year 1971 to 2017. Secondary data on foreign direct investment and economic growth was obtained from Kenya National Bureau of Statistics (KNBS), the World Bank and the Central Bank of Kenya. The collected quantitative data was edited and coded and entered into a Stata version 14 for analysis. Both descriptive and inferential statistics were used to analyze quantitative data. In descriptive statistics, the study used frequency distributions, mean, standard deviation and percentages. In relation to inferential statistics, the study made use of analysis of variance, correlation analysis and univariate regression analysis. The inferential statistics were used to evaluate the relationship between the dependent and the independent variables. The correlation analysis was used to establish whether there is an association between the dependent and the independent variables. A univariate regression analysis was also carried out to determine the weight of the relationship between dependent variable and the independent variable. The study found that foreign direct investment has a positive and significant influence on economic growth in Kenya. The government of Kenya should improve conditions that can make the Kenyan market more attractive to invest in. These strategies should include the use of tax subsidy and tax relief and tax holiday. In addition, the government should focus on improving infrastructure including roads, railway, water supply and electricity supply.

Key Words: Foreign Direct Investment, Economic Growth, Gross Domestic Product

Introduction

Economic growth involves a raise in an economy's production capacity which enables the economy to produce extra goods and services (Ndambiri, Ritho & Ng'ang'a, 2012). Economic growth enables a rise in both the living standards and the economic welfare of the people existing in a certain economy. Gutema (2018) argues that the growth of the economy results to reduction in poverty level, increases employment rate, increases tax revenue, encourages investment and leads to an improvement in public service delivery. In the 19th century, there was a very high rate of poverty in Europe; however after a century of economic growth, almost everyone had improved their standards of living. This shows the essence of promoting economic growth in the developing nations. In addition, while a stationary economy promotes unemployment and social misery, economic growth increases demand and hence companies increase employment rates (Kaara, 2015). Further, high rate of economic growth increases

the government's revenue through increasing income, corporation and expenditure taxes, which can be spent in improving public services (Sharma, Kautish, & Kumar, 2018).

All over the world, economic growth has over the years been decreasing, as shown in Figure 1. The highest GDP growth of was in 1964 at 6.6 per cent while the lowest was in 2009 at -1.73 per cent. In addition, the global GDP growth was 0.74 per cent in 1975 and 0.39 per cent in 1982. The 2009 decrease in economic growth could be attributed to the 2007–2008 financial crises, which are referred to as the worldwide financial crisis as well as the 2008 financial crisis; Many economists consider this crisis as the super financial crisis since the 1930s Great Depression (UNCTAD, 2017).

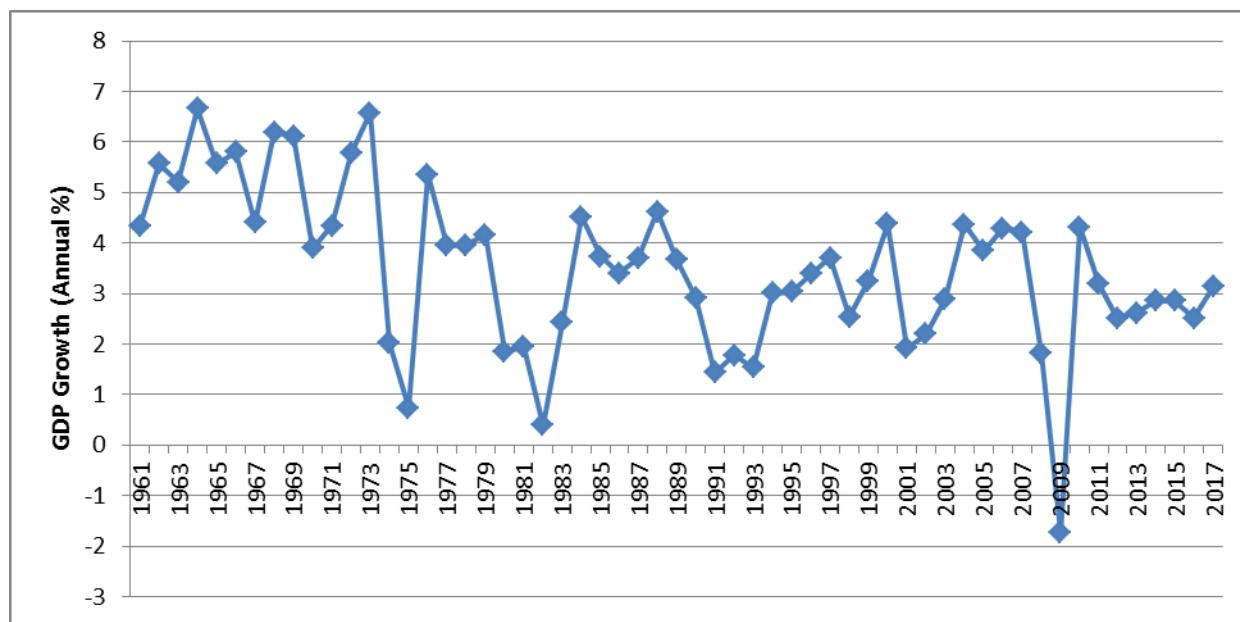


Figure 1: Global GDP Growth
Source: UNCTAD (2017)

In the year 2000, Rwanda had the highest GDP growth at 8.37 per cent among East African Countries, followed by Tanzania at 4.93 per cent, Uganda at 3.14 per cent, Kenya at 0.599 per cent and Burundi at -0.85 per cent. In the year 2017, Tanzania had a GDP growth of 7.10 %, followed by Rwanda at 6.05 %, Kenya at 4.87 per cent, Uganda at 3.86 per cent and Burundi at 0.50 per cent. One of the main trends that can be observed from the performance of economic growth in East Africa Community Counties for the last 17 years is considerable fluctuations. It is therefore, important to understand what causes fluctuations in economic growth so as to enable policy development and review.

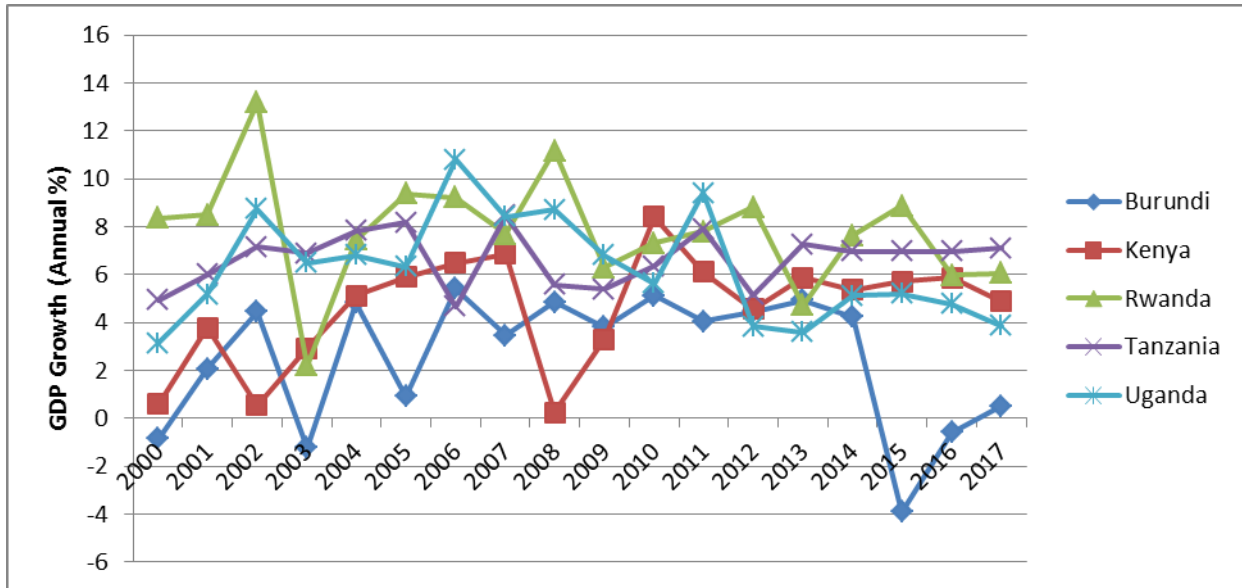


Figure 2: East Africa Community Countries' GDP Growth

Source: UNCTAD (2017)

For a long duration of time, Kenya has failed to achieve constant economic growth. The growth rate of Kenyan economy has been fluctuating since 1960s whereby the economy had a higher growth rate between 1960s and early 1970s which was followed by a decline in performance in mid-1970. From 1974 to 1993, real GDP recorded a negative growth due to cut in supply of both multilateral and bilateral aid as a result of resource mismanagement and shrinking of agricultural production.

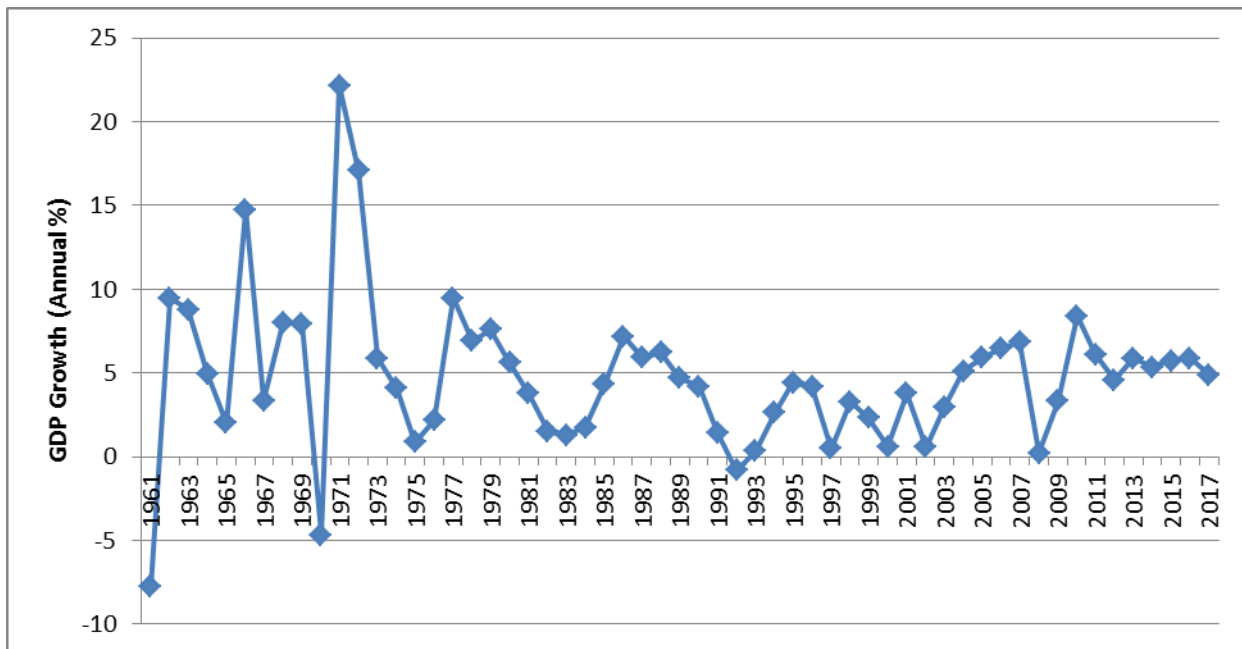


Figure 3: GDP Growth in Kenya

Source: UNCTAD (2017)

In general, FDI occurs when potential investors make investments on another country's firm operations or gain foreign firm assets, with inclusion of ownership establishment or control of interest of a firm in another country (Anderson, 2010). FDI assets determine the overall level of investments done directly in a certain period of time, usually the end of three months or one year. The outward FDI stock is the worth of citizens' invested capital in loans and net loans to firms in other countries' economies (Goedhuys, 2017). FDI is essential for establishing emerging market nations. Their firms need a global funding and experts to increase their global sale. Their nations need private infrastructure investors, investors in energy, and water with an aim of increasing employment and salaries which ultimately result to improvement in economic growth of the host country. However, business might be stripped by foreign investors without any addition. Portions which are not profitable in foreign firms could be sold to domestic and unsophisticated investors, in addition the firm collaterals can be used to secure local loans with low interest rates. Instead of making reinvestments, they lend the funds back to the mother firm thus negatively affecting economic growth of the host country (Dunning & Pitelis, 2018).

Statement of the Problem

Economic growth in Kenya has been fluctuating since the year 1961. From a GDP growth rate of 22.174 per cent in 1971, economic growth has decreased over the years to 4.874 per cent in 2017. In addition, GDP growth rate declined from 5.879 % in 2013 to 5.357 % in 2015 and from 5.869 per cent in 2016 to 4.874 per cent in 2017 (The World Bank, 2018). FDIs in Kenya have been fluctuating over the years. In the end of 2010, Kenya attracted only 12.9 percent of FDI in the EAC region while Tanzania and Uganda attracted 30.1 percent and 56.9 percent respectively. Also, Kenya's FDIs decreased by 27.04 % to \$259 million in 2017 from \$355 million in 2016 (UNCTAD, 2017). The fluctuating and at times decreasing, economic growth is denying Kenya an opportunity to create more jobs, reduce poverty and attract investments. In addition, economic growth is watched closely by global investors and their interest in investing in a country is shown by foreign direct investment (Kenya National Bureau of Statistics, 2017). Therefore, it is important to establish the effect of foreign direct investment on economic growth in Kenya so as to guide policy formulation to improve the national economy.

Various studies conducted in Kenya on the foreign direct investment and economic growth have shown mixed findings. For instance, Mahembe and Odhiambo (2014) researched on the influence of FDI on economic growth in Kenya and found that FDI had no positive effect on economic growth. However, Wanjiku (2016) conducted a study on the impact of foreign direct investment on economic growth in Kenya. This study therefore sought to investigate the effect of foreign direct investment on economic growth in Kenya (1971-2017).

The following is the null hypothesis that was tested in this study:

H₀1: Foreign direct investment has no significant influence on economic growth in Kenya

Theoretical Review

This study was anchored on the Eclectic paradigm of dunning (FDI) theory. Dunning (1980) developed the eclectic paradigm for global production by incorporating market imperfection structures, location theory and trans-cost market imperfections. The theory considers the nature of a country's involvement in international relations by analyzing two types of involvement. The first involvement is concerned with economic activities taking place within the boundaries, and thus using national resources, but

concerning goods and services directed to foreign market. The second involvement is concerned with activities of national economic agents using resources located in various countries to produce goods and services for foreign market. Dunning (1980) argues that the first involvement falls within the conventional international trade theory. The second involvement falls within the domain of international production and FDI. He further argues that the two are part of the same process. He asserts that in terms of a country's involvement, one has to explain why and when foreign markets are sourced through FDI and international production rather than production and exports. This approach is an attempt to analyze why and where decisions in terms of ownership, locational and internalization advantages (known as OLI advantages) (Rochon & Vernengo, 2013).

The essence of electric approach is in considering those advantages altogether and in applying them to both international trade and production. Ownership advantages are specific to a particular enterprise (such as technology, marketing and production skills). If this advantage is exploited optimally, a firm can overcome and can be compensated for additional costs of establishing production facilities abroad (Pegkas, 2018). This advantage also gives the firm the ability for additional costs of establishing production facilities abroad. Locational advantages (L) are specific to countries likely to attract foreign investors. Under these factors such as large markets, government policies, the country's trade policy and superior infrastructure are included. Finally the firm gets greater benefits by exploiting both ownership and locational advantages by internalization (I). Firms do internalization due to the fact that markets for assets and product such as technology and knowledge are imperfect. The ownership and Internationalization are specific to a particular firm but the location advantages are specific to the host country and have an essential impact on a host country's inflow of FDI. The advantages must occur jointly for FDI to occur (Rugman, 2010).

Dunning's eclectic paradigm indicates that, increase in globalization, ownership and location advantages will lead to integration of entry modes by companies for example FDI or joint ventures, versus export or licensing (Chirwa and Odhiambo, 2016). Dunning (1998) states that the prior case deals with investment strategies having assets as a priority, through which FDI investments are applied in merging companies or in acquisition, with an aim of ensuring horizontal efficiency. In the other case, there is vertical efficiency which is characterized by search for resources and markets. The relevance of internalization advantages informs this research. Despite the criticism, this theory is diverse in establishing FDI determinants and their impact. This makes the theory relevant and useful. This study considers OLI framework in hypothesizing the socioeconomic determinants of FDI inflows in Kenya.

Conceptual Framework

The study sought to investigate the determinants of economic growth in Kenya. The independent variable was foreign direct investment and the dependent variable was economic growth in Kenya. The study sought to investigate the association between the independent variable (foreign direct investment) and the dependent variable (economic growth).

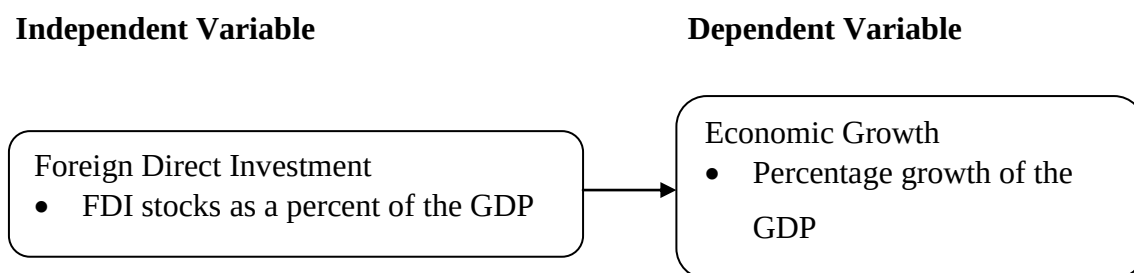


Figure 4: Conceptual Framework

Empirical Review

Moudatsou (2003) conducted a study on FDI and Economic Growth in the European Union. The study targeted 14 countries in the European Union the data used covered a period of 16 years from 1980-1996. Study findings revealed that foreign direct investment affected economic growth in a positive and significant way. It was shown that the effect was through trade reinforcement in a direct and indirect way. Also, results showed that growth impact of FDI was not dependent on the level of human capital in the industrialized host nations.

Adeleke, Olowe and Oluwafolakemi (2014) researched on the relationship between FDI and economic growth in Nigeria. The area of concern was the Nigerian economy from 1999-2013. The secondary data used was got from the central bank of Nigeria. Study results revealed that FDI inflow had a significant and positive influence on economic growth. The study findings showed that there was a significance level of 5 percent which was a clear indication that the improved economic performance was as a result of FDI inflow. It was concluded that FDI inflow is a catalyst to economic growth

Melnyk, Kubatko and Pysarenko (2014) researched on the relationship between FDI and economic growth in former Comecon transitional and developing economies. The study deployed neoclassical growth theory model for analysis of FDI influence on economic growth. The study targeted on 26 developing and transition countries. Study findings revealed that there was a significant and positive relationship between FDI and economic growth. FDI is directly proportional to economic growth; this means an increase in FDI leads to increased rate of economic growth. Financial sectors and institutional sectors which are well developed play an essential role of ensuring both economic and GDP growth. The economic growth in host nations grows in a faster rate. This is indicated by high development rate of infrastructure, increased bank reforms as well as implementation of institutional policies.

Carbonell and Werner (2018) based their study on the influence of FDI on economic growth in Spain. Empirical methodology was deployed by the study with an aim of establishing the influence of FDI on Spanish economic growth. During the observation Period 1984–2010 the findings revealed that FDI influenced economic growth positively. However a combination of foreign direct investment and other variables like the influence of bank credit on real economic growth; study findings showed that the favorable economic circumstance in Spain does not show evidence on how FDI stimulates economic growth. The economic growth in Spain is neither affected by the Spanish EU nor the euro entry.

Antw and Zhao (2013) researched on the influence of FDI on Economic Growth in Ghana. The study dependent on data from the World Banks World Development Indicators 2011 CD ROM the study was done from 1980 to 2010 in china. The study established that a long-run equilibrium and causal

relationship exists between the foreign direct investments and two independent variables under concern specifically, gross national income and gross domestic product. It was further revealed that gross domestic product and gross national income also influenced economic growth. Results showed that in the short-run, influence of gross domestic product and gross national income volatility on foreign domestic investment was nearly imaginary.

Mahembe and Odhiambo (2014) researched on the influence of FDI on economic growth in Kenya. The study deployed both exogenous and endogenous growth analysis, study findings revealed that FDI had both direct and indirect influence on economic growth, and that more FDI investments could be attracted by the growth of the host country. Findings also revealed that foreign direct investment influenced the growth of the economy through two major ways; technological spillovers by FDI investments encourages new technology adoption; technology transfer can be stimulated by FDI investments through introduction of new management alternative practices, labor training as well as skill acquisition. Study findings further revealed that the host country's social economic factors greatly determined the influence of FDI on economic growth. Through literature review it was clearly established that the economic growth in the host country could be boosted by FDI through increasing the diffusion of both capital and technology. Nevertheless, the influence was dependent on certain factors in the host country the diffusion of education, technology and competence. Other essential conditions include cultural political and social factors.

Research Methodology

The present study adopted explanatory research design. The study adopted the explanatory research design since it sought to determine causal relationship between independent variable (foreign direct investment) and dependent variable (economic growth). The target population of the present study was data of the period of 1971 to 2017. Convenience sampling was used in this study to sample data along the years. While data on some variables like economic growth (GDP) is available from 1960, data on foreign direct investment was available from 1971. In addition, 2018 data on foreign direct investment was not available. The study therefore used the period between 1971 and 2017.

Secondary time-series data was used in the present study. Secondary data covered a period of January, 1971 to December, 2017. Data on foreign direct investment was obtained from Kenya National Bureau of Statistics (KNBS), the World Bank and the Central Bank of Kenya. The secondary data was collected by use of a data extraction checklist.

Secondary data that was used in the present research was in quantitative form. The quantitative data was collected, edited and coded into Statistical software known as Stata version 2014, for statistical analysis. Analysis of the quantitative data was based on descriptive and inferential statistics. Descriptive statistics focused on computation of mean, percentage, standard deviation and frequencies. Inferential statistics focused on calculation of correlation and univariate regression analysis. Correlation analysis was used to determine the strength of the association between dependent and independent variable while univariate regression analysis determined the relationship between the elements or variables under investigation.

Regression model was used in the present study to model the linear association between dependent (economic growth) and independent variable (foreign direct investment). The regression model was as follows;

$$GDP_t = \beta_0 + \beta_{1t}FDI_t + \varepsilon_t \dots\dots\dots (1)$$

GDP_t is the dependent variable (Gross Domestic Product), B_0 is the y intercept (Constant), β_1 is the coefficients of determination, FDI_t is the Foreign Direct Investment, t represents time and ε_t is an error term.

In order to test for the assumption in regression analysis, including Vector Auto Regression (VAR), the researcher used diagnostic test before performing the regression analysis. Specifically, the test focused on linearity test, autocorrelation test, testing for heteroscedasticity, normality, multicollinearity and stationarity test.

Research Findings and Discussion

Descriptive Statistics

In this study, descriptive statistics entailed calculation of standard deviation, mean, maximum and minimum of dependent variable (economic growth) and the independent variable, foreign direct investment. The results, as shown in Table 1, indicated that the average Gross Domestic Product for the period between 1971 and 2017 was 4.753801 per cent and the standard deviation was 4.008427 per cent. The minimum Gross Domestic Product growth was -0.799494 in 1992 and the maximum was 22.17389 in 1971. In addition, the average term of trade in Kenya for the period between 1971 and 2017 was -6.514894 and the standard deviation was 4.611011.

Table 1: Mean Estimation

Variable	Obs	Mean	Std. Dev.	Min	Max
GDP	47	4.753801	4.008427	-.799494	22.17389
FDI	47	.7467643	.7550896	.004721	3.457345

Figure 5 shows the trend of GDP growth for the period ranging from 1971 to 2017. According to the findings, GDP growth in Kenya has been fluctuating over the years. The highest GDP growth for the period between 1971 and 2017 was in the year 1971 at 22.174% and in the year 1972 at 17.82%. Other peaks during the study period were in 1977 at 9.454%, 1986 at 7.178%, 1995 at 4.406%, 2007 at 6.851% and 2010 at 8.406%. However, GDP growth was lowest in 1992 at -0.799%. Other years with low economic growth were 1975 at 0.882%, 1997 at 0.475% and 2008 at 0.232%. In the year 1992, low economic growth can be attributed to tribal clashes and elections while low economic growth in 2008 can be attributed to post-election violence.

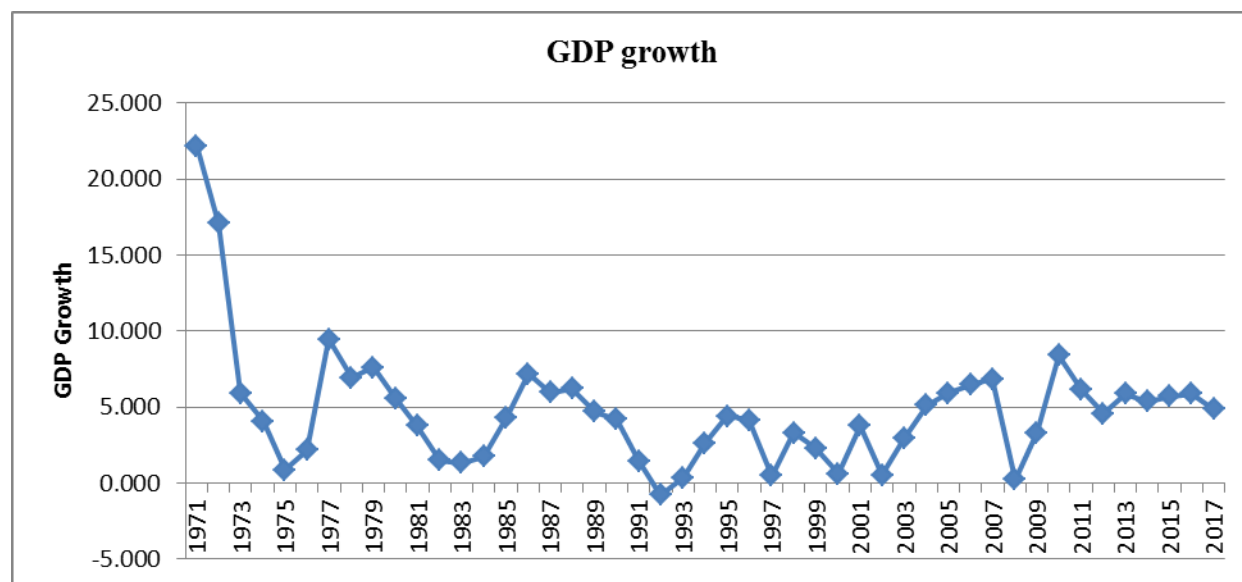


Figure 5: Trend of Economic Growth

Foreign Direct Investment was measured as net inflows as per cent of GDP. Figure 6 shows the trend of foreign direct investment for the period ranging from 1971 to 2017. From the findings, foreign direct investment has been fluctuating over the years. The highest foreign inflow in Kenya was in the year 1971 at 3.457 per cent. Other years that had high foreign inflows were in the years 1972 at 2.738 per cent, 1988 at 2.532 per cent, 1986 at 2.281 per cent and 2010 at 2.031 per cent. During the study period, the years with the lowest foreign direct investment foreign inflows were in 1993 at 0.005 per cent, 2001 at 0.041 per cent, 1993 at 0.005 and 1984 at 0.174 per cent. These findings imply that foreign direct investment has been fluctuating over the years for the period between 1971 and 2017.

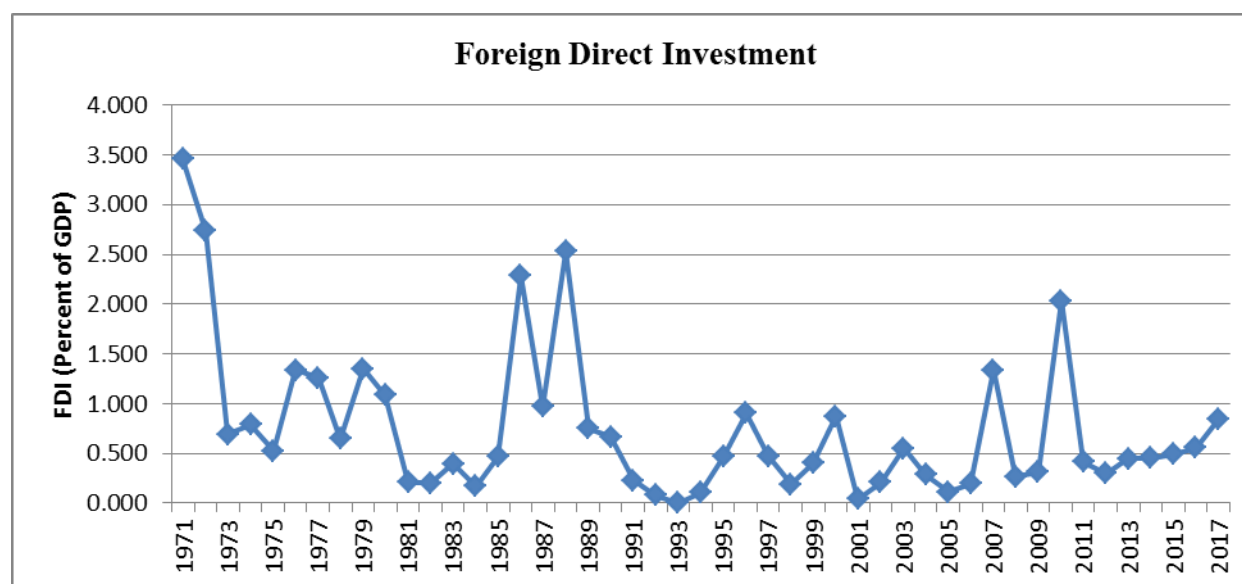


Figure 6: Trend of Foreign Direct Investment

Correlation Analysis

Correlation coefficient is considered to be measure used in measuring the relationship between two variables, which can be both independent variables or an independent variable and dependent variable. The results show that there is a positive and significant relationship between foreign direct investment and economic growth (GDP) in Kenya ($r = 0.778$, $p\text{-value} = 0.000$). The findings agree with Leitão and Rasekhi (2013) argument that foreign direct investment influence economic growth through stimulation of completion, ensuring upgraded managerial processes and technological processes, ensuring market development and labor force learning. The findings also agree with Melnyk, Kubatko and Pysarenko (2014) argument that FDI is directly proportional to economic growth; this means an increase in FDI leads to increased rate of economic growth. In the United States, Asheghian (2015) established that FDI growth and globalization influences economic growth in a positive way, and FDI has a positive influence on factor productivity, in addition to facilitating economic growth in USA.

Table 2: Correlations Coefficient

		GDP	Foreign investments	direct
GDP	Pearson Correlation	1		
	Sig. (2-tailed)			
	N	47		
Foreign direct investments	Pearson Correlation	.778**	1	
	Sig. (2-tailed)	.000		
	N	47	47	

**. Correlation is significant at the 0.01 level (2-tailed).

Regression Analysis

The study sought to determine the influence of foreign direct investment on economic growth in Kenya. The null hypotheses were as follows:

H₀: Foreign direct investment has no significant influence on economic growth in Kenya

The R-squared for the relationship between foreign direct investment and economic growth in Kenya in this study was 0.6060, which implies that foreign direct investment can explain 60.60% of the economic growth in Kenya. In addition, the p-value for the F-statistic was 0.000, which implies that the model can be used in predicting the influence of foreign direct investment on economic growth in Kenya.

The results show that foreign direct investment has a positive and significant influence on economic growth in Kenya as shown by a regression coefficient of 4.132423. The p-value (0.000) was more than the significance level (0.05) and hence we can reject the null hypothesis indicating that “foreign direct investment has no significant influence on economic growth in Kenya”. These findings agree with Adeleke, Olowe and Oluwafolakemi (2014) findings that FDI inflow had a significant and positive influence on economic growth. The findings are contrary to Pandya and Sisombat (2017) findings that foreign direct investment inflows had a slight impact on economic growth which in turn influences the growth in gross domestic product, increased export transactions and improved employment.

Table 3: Regression Coefficients for FDI and Economic Growth

Source	SS	df	MS	Number of obs = 47		
Model	447.88281	1	447.88281	F(1, 45) = 69.21		
Residual	291.221632	45	6.47159182	Prob > F = 0.0000		
Total	739.104442	46	16.0674879	R-squared = 0.6060		
				Adj R-squared = 0.5972		
				Root MSE = 2.5439		

GDP	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
FDI	4.132423	.4967389	8.32	0.000	3.13194	5.132907
_cons	1.667854	.5246856	3.18	0.003	.6110834	2.724626

Summary of the Findings

The study found that foreign direct investment significantly affects the growth of the Kenya economy. Economic theories indicate that FDI have significant influence on development of national strategy in three ways. First, FDI (capital inflow) enables a particular state to import more than it exports thus enabling it to save extensively invest than saving ultimately resulting to rapid accumulation of capital to foster productivity of labor. Moreover, FDI can lead to absorption of surplus literate manpower in formal and informal sectors. Creation of employment and enhancing productivity through entrepreneurship plays an integral role in poverty alleviation. Besides that, FDI can lead to expertise and technological transfer thus stimulating growth of local firms. This occurs through competition, emulation in industrial settings and training. For instance, foreign firms often provide domestic enterprises to input and output markets provided there are favorable importation terms than exportation conditions.

According to the study's findings, the FDI has significant influence on growth of economy, henceforth; the government encourages FDI through implementing strict regulation and rules to prevent micromanagement of foreign investment. It also favors some industrial sectors with targeted subsidies while forestalls other industries through setting legislations. In addition, it is prudent to pay much attention to policies which enhance growth of economy thus attracting FDI. The trends also reveal that the FDIs in some states tend to attract much higher FDIs compared to others. The republic of Kenya has quite low FDI, hence, there is need to improve on entrepreneurship environment through setting administrative procedure, functional judicial and legal system so as to fight against corruption, ensure adherence to the set rules and enable investors to enjoy their property rights. Henceforth, this will enable the country to improve on its FDIs.

Conclusion and Recommendations

The study also concludes that FDI has positive and significant influence on the growth of economy in Kenya. This implies that FDI with respect to foreign inflows results to improvement in the growth of economy. It also contributes to development through capital inflows, employment creation and transfer of technology and skilled-manpower thus enhancing productivity of local firms.

Monetary and fiscal policies are established to encourage FDI in the country thus resulting to high and sustainable economic growth. The key role of policy recommendation is to attract exportation oriented FDI in industrial sector. In addition, the government of Kenya should improve conditions that can make the Kenyan market more attractive to invest in. These strategies should include the use of tax subsidy and tax relief and tax holiday. In addition, the government should focus on improving infrastructure including roads, railway, water supply and electricity supply.

Suggestions for Further Studies

This study was conducted on the influence foreign direct investment on economic growth in Kenya. However, different countries around the world are characterized by different macroeconomic factors and hence findings from one country cannot be generalized to other countries. Therefore, comparative studies should be conducted on the influence foreign direct investment on economic growth in developing and developed Countries. In addition, comparative studies should be conducted on the influence foreign direct investment on economic growth in developing countries like East African region countries. The study found that foreign direct investment could explain 60.60% of economic growth in Kenya. This study therefore suggests further studies on other determinants of economic growth in Kenya.

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