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RESEARCH ARTICLE

IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH IN KENYA

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ABSTRACT

The aim of the paper was to determine the extent to which FDI inflows in the infrastructure sector, the manufacturing sector and the agricultural sector impact Kenya's economic growth. The results of the study show that FDI in the infrastructure sector has had a positive and significant impact on economic growth while the manufacturing and agriculture sectors have had a positive although such positive effect were insignificant. Unlike the manufacturing sector foreign direct investment inflows to the agricultural sector are relatively small which may be the cause of little impact.

INTRODUCTION

In Africa foreign direct investment is considered more of a necessity in promoting growth. The main reason behind this is that FDI aids to address the two major problems that majority of African countries face insufficient technology and skills and the savings gap which in turn reduces poverty levels and improves living standards. Kenya attracted foreign investors in the 1960 and 1970 but has since been grossly inadequate over the past decades UNCTAD (2013). Despite the fact that Kenya is a country on move and is seen as an economy pivoted by exports, technology and knowledge based enterprises, the economy is now seen as an encouraging economy for foreign investors as it offers tremendous opportunities for growth and future success. Foreign direct investment FDI was seen as a core driver of Kenya's sustained economic growth performance United Nations (2005), a more active strategy has been developed to attract foreign direct investment. The Kenyan government has resolved to focus more on problems such as the manufacture of consumer goods, the promotion of agribusiness activities, the diversification of export processing zone activities and the making of Kenya a regional service center UNCTAD (2013).

Types of FDI in Kenya: In theory FDI is classified in a variety of ways but for the purposes of this research. We will apply the classification of trade related foreign direct investment.

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As a result FDI falls into three broad categories: export oriented FDI, import oriented foreign direct investment and government oriented FDI. The aim of Import oriented FDI is to replace economic imports by establishing a basis in the host country. In Kenya the assembling industry could be identified as the best example of such foreign direct investment. Export oriented FDI is based on finding the less expensive factors of production that host countries may have. It was a matter of great interest that government sponsored foreign direct investment was triggered when governments offered incentives to foreign investors. These incentives for example have led to an increase in the number of foreign companies in Kenya's export processing zones, the introduction of export processing zones in 1990 attracted more foreign direct investment. In 2003 EPZs accounted for the most of operating enterprises accounting for 71% per cent of total foreign direct investment compared with 16% per cent for Kenyan and foreign joint ventures UNCTAD (2006).The establishment of special economic zones such as Konza and Tatu will continue to attract more inflows of such foreign direct investment. In terms of spillovers FDI inflows in the communications, construction, trade and the transport sectors have the highest degree of post linking to the economy, while foreign direct investment flows to manufacturing, transport, communications and financial services are considered to have the highest levels of forward linkage. However most FDI inflows to Kenya are in the primary sector with the lowest degree of post linkage linkages in the primary sector as the sector is less merged with other sectors in the purchase of its core inputs Kenya therefore needs to ensure that foreign direct investment flows are attracted and that post linking linkages are provided to promote overall economic growth.

Problem statement: Whenever a country's economy is facing a crisis situation it usually implements a number of structural adjustment schemes mandated at bringing back the economy in the short or long term. Having foreign direct investment inflows and actually seeing their influence on the economy are two different things "Foreign direct investment FDI makes a positive contribution to income growth and the productivity on condition that the host country has reached a certain level of absorptive capacity" OECD (2002). Although there have been many changes in Kenya's economic structure and policy research the level of foreign direct investment in Kenya is low World Bank (2004). The problem therefore is that in addition to the inconclusive report on the special impact of foreign direct investment on the economy the levels of FDI in Kenya has declined over the past years and requires the implementation of various structural and policy measures or a number of adjustments. Current work has been carried out such as the 2030 Vision launched in 2008 to make sure that Kenya become a middle income economy with a sustainable growth level of 10% per cent and above.

Objectives of the study: The objective of the study was to research the impact of foreign direct investment on Kenya's economic growth. The basic objectives that this study seeks to achieve are as follows:

- Determine the extent of the impact of FDI inflows in the infrastructure sector on Kenya's economic growth
- Determining the extent of the impact of FDI inflows in the manufacturing sector on Kenya's economic growth
- Determine the extent of the impact of FDI inflows in the agricultural sector on Kenya's economic growth

Literature Review

Economic theory predicts that FDI will have a growth multiplier effect via vertical as well as horizontal spillover effects comprising the transfer of technology to domestic enterprises, the human capital formation etc. Empirical evidence doubts the degree of horizontal spillover effects but also provides comprehensive and convincing evidence of the existence and importance of vertical spillover effects in manufacturing. Liesbeth ET (2008) Carkovic and Levine (2002) noted that the economic validation for providing incentives to attract foreign direct investment often stems from the belief that FDI generates external factors in technological form and spillover. Foreign direct investment FDI is a crucial tool for technology transfer and promotes growth to a greater extent rather than just focusing on domestic investment. For Africa and Kenya in particular, to ensure sustainable foreign direct investment there must be political steadiness, good infrastructure and economic steadiness. If all of this is in place the African continent will be capable to attract foreign direct investment in the same way as other developing countries Adewumi (2006).

Significance of the study: Most of the studies on foreign direct investment are based on quantitative analysis and trends over the years. One of the objectives of the study was to provide information on the extent of the impact of foreign direct investment by sector on our economic growth. In addition the study will help to provide information on which sectors are performing well in terms of FDI flows and which sectors need to be improved. This will help to review policies and regulations in order to create an enabling environment for drawing more foreign direct investment into the country.

MATERIALS AND METHODS

Quantitative data were used in the study to answer the study equation. The researchers collected level two data from the World Bank and the Kenya National Bureau of Statistics KNBS from 2000 to 2017. In order to analyses growth within or between countries the augmented Solow model developed by Mankiw (1992) was able to include variables associated with trade foreign direct investments. The growth model for this research will include foreign direct investment by sector. Economic growth = f {Foreign direct investment [manufacturing infrastructure agriculture]. These functions illustrate the growth model in which growth economic growth as measured by GDP is a dependent variable, while foreign direct investment FDI by sector (infrastructure, manufacturing and agriculture) are independent variables. The following formula summarizes empirical models of the potential influence that FDI may have on economic growth by sector. Where GDP = Economic growth of a Country, Cap = Gross fixed capital formation percentage of GDP, Lab = Labor force total, $FDI.Mf$ = FDI inflows in Manufacturing Sector, FDI.Inf = FDI inflows in Infrastructure Sector, $FDI.Agr$ = FDI inflows in Agriculture sector, μ is the error term.

ANALYSIS AND FINDINGS

The study aims to examine the influence of foreign direct investment on Kenya's economic growth. The study is guided by specific objectives to determine the extent to which FDI inflows to the infrastructure sector, the manufacturing sector and the agricultural sector affect Kenya's economic growth.

The Extent To Which Fdi Inflows To The Infrastructure Sector Have Had A Impact On Kenya's Economic Growth: Results have shown that foreign direct investment in the infrastructure sector has a significant impact on economic growth. The growth of foreign direct investment units in the infrastructure sector has led to economic growth accounting for 0.02% per cent of gross domestic product. The results of the study indicate that foreign direct investment in Kenya emphasize on infrastructure related activities.

Extent of the impact of FDI Flows in Manufacturing on Kenya's Economic Growth: The results of the study show that foreign direct investment FDI is invested in manufacturing MF has no significant impact on economic growth. The growth of foreign direct investment units in manufacturing has led to economic growth accounting for 0.09% per cent of gross domestic product. The reasons for this difference can be traced back to the introduction of privately owned industries a policy that has resulted in a significant increase in FDI inflows to this sector as it has attracted investors from around the world to Kenya. But the results of the measurement analysis show that foreign direct investment in manufacturing FDI MF sector has had no significant impact on Kenya's economic growth.

Extent of the impact of FDI Inflows on Kenya's Economic Growth in the Agricultural Sector: The results of the study show that FDI in the agricultural sector FDI AGR has no significant impact on economic growth. The growth of foreign direct investment units in the agricultural sector has led to

Table 1. Unit root test results

Variable	Test statistic lag(1)	Interpolated Dickey Fuller			MacKinnon approximate P value	Null hypothesi	Conclusion
		1% Critical Value	5% Critical Value	10% Critical Value			
Growth	Z(t)	-3.77	-3.00	-2.60	0.0069	There is a unit root	Rejected

Table 2. Multicollinearity test results

Assumed Dependent Variable	R2 for the auxiliary regression	R2 for the original regression
Capital	0.214	0.251
Labor	0.176	0.251
FDI_infl	0.022	0.251
FDI_Mf	0.014	0.251
FDI_Agr	0.009	0.251

Conclusion: No multicollinearity

Table 3. The multiple regression output

Variable	Coefficient	Robust.	t.	p>t	Vif	1/vif
Capital	(0.078)	.0617921	-1.27	0.234	3.40	0.294
Labor	(0.00001)	6.87e-08	-6.34	0.000	2.78	0.360
FDI_infl	0.0002	0.0010064	3.16	0.030	1.99	0.503
FDI_Mf	0.001	.001858	0.24	0.620	1.88	0 .531
FDI_Agr	0.046	0.0390973	0.36	0.263	1.83	0.548
Constant	5.744	0.6449218	4.32	0.000	Mean VIF 2.376	

economic growth accounting for 0.46 per cent of gross domestic product. The finding are contrary to Onakoya (2012) which considers foreign direct investment in the agricultural sector to have a significant impact on Kenya's economic growth. The lack or inflow of relatively small inflows of foreign direct investment in the agricultural sector may be the cause of this negligible impact EK (2007).

Conclusions and Policy Implications

Based on the results and conclusions of the research the following recommendations were made; Participate in bilateral as well as multilateral trade agreements to open up the economy and improving the infrastructure quality by channeling more resources to development particularly in the marginal parts of the country. Improve existing policies and political will in fighting corruption in order to instill more confidence in foreign investors. These policies can enhance the attractiveness of FDI and thus promote economic growth. With regard to the findings of paper it can be concluded that foreign direct investment in the infrastructure sector has a positive and significant influence on economic growth while agriculture and manufacturing have a positive but an insignificant influence on Kenya's economic growth. Unlike the manufacturing sector foreign direct investment inflows to the agricultural sector are relatively small which may be the cause of little impact.

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