



Foreign Direct Investment and Tanzania Economic Performance: An Empirical Analysis Over 1980-2020 Period

Bilame, O.

Department of Economics, University of Dodoma, Dodoma, P.o.Box 259, Dodoma, Tanzania

Correspondence: obilame@gmail.com

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Abstract: *This paper provides an empirical analysis of foreign direct investments and economic performance in Tanzania over the 1980-2020 period. The main objective of the study was to assess the influence of foreign direct investments (FDI) on the economic growth trends in Tanzania over the 1980-2020 period. Specifically, this paper sought to assess the extent to which FDIs have played a role in influencing economic growth in Tanzania. This study employed the Augmented Dickey-Fuller (ADF) and Phillips-Perron unit root tests were carried out to test for unit root. A test for cointegration reveals that there is cointegration and only one maximum rank of this cointegration thus an Error Correction Model (ECM) is applied to mitigate cointegration followed by the Engle-Granger two-step procedures because there is only one cointegrating vector. Generally, the findings show that the error correction model is positively related to economic growth implying that, GDP growth expands as FDI increases. Domestic investment is negatively related to economic growth implying that FDIs “crowd out” domestic investment. The exchange rate is positively related to economic growth which leads to the appreciation of a domestic currency.*

Keywords: *Economic growth, foreign direct investment, exports, exchange rate, policy reforms*

1.0 Background Information

Foreign Direct Investments (FDIs) are important aspects of the economic development of host countries, and crucial, in building the technological capabilities of local companies in developing countries (Diyamett and Mutambla, 2015). It is a channel for international diffusion of technology, having the potential to transfer technological, organizational and managerial practices to developing countries. And in the long run, may lead to higher technological capabilities and innovation and thus bring about economic growth in these countries. However, much as FDIs may accelerate economic growth in the host countries, they should not crowd out domestic investments.

Tanzania is one of Africa’s best-performing countries in terms of Gross Domestic Product (GDP) growth and attracting foreign direct investment. With its remarkable set of natural assets, long-term stable democracy and strong macroeconomic performance, Tanzania has the potential to attract much greater Foreign Direct Investments (FDI) inflows (URT, 2009; IFM, 2018). The country has continued with efforts to improve the investment climate and promote both foreign and domestic investments with the view to consolidating macroeconomic gains.

One of the important factors that influence economic growth is an investment and its contribution is of crucial role in accelerating GDP growth. FDI inflows over the past two decades have increased significantly worldwide. For instance, global flows of FDI rose from USD 1.35 trillion in 2012 to 1.75 trillion in 2017 (UNCTAD, 2016; IMF, 2018). It has been theorized by development economists that the

integration of developing countries with the global economy increased sharply in the 1990s with changes in their economic policies and the lowering of barriers to trade and investment. Most countries strive to attract FDI because of its acknowledged advantages as a tool of economic growth. Africa joined the rest of the world in seeking FDI as evidenced by the formation of the New Partnership for Africa’s Development (NEPAD). Indeed, NEPAD has attracted foreign investments to Africa that have played a great role in influencing macroeconomic variables (UNCTAD, 2016). The FDIs are assumed to benefit poor countries, not only by supplementing domestic investment but also in terms of employment creation, transfer of technology, increased domestic competition and other positive externalities (Imoudu, 2012).

To this end, this paper aimed to assess the influence of foreign direct investment on the economic growth trend in



Tanzania from 1980 to 2020. Specifically, this paper sought to assess the extent to which FDIs have played a role in influencing economic growth along with examining the influence of the same on the growth of domestic investments and exchange rates. The study was guided by the following hypotheses: firstly, foreign direct investment has no significant influence on the GDP growth; secondly, foreign direct investment ‘crowds out’ domestic investment growth; and thirdly, foreign direct investment has no significant influence on the appreciation of a domestic currency.

2.0 Overview of Tanzania Economy

2.1 From the early 1980s to the 1990s

The modest macroeconomic performance that Tanzania achieved until the mid-1970s was completely wiped out by the unfavourable external conditions which led to the crisis period 1980-85 Tanzania. Even the coffee boom Tanzania experienced between 1975 and 1977 when coffee prices tripled because of coffee frost in Brazil, could not compensate for the negative consequences of the oil price shocks in 1973/74 and 1979 and the war with Uganda that began in October 1978 (Ndulu, 1989).

During the early 1980s, Tanzania’s economic performance deteriorated considerably. Despite all efforts under the development ideology of socialism in the name of “Ujamaa”, Tanzania’s economy remained largely inefficient, resulting in low growth rates and poor product quality by international standards. Indeed, GDP growth rates for 1981 and 1983 were -0.5 and -2.3 per cent respectively (Mbele and Mashindano, 1995).

Moreover, the extremely overvalued exchange rate decreased the country’s competitiveness in the area of meagre traditional export commodities, thereby diminishing export earnings. In addition, Tanzania’s terms of trade deteriorated severely in the early 1980s because of collapsing world market prices. Consequently, the trade deficit increased, foreign capital inflows decreased and overall indebtedness exceeded critical levels. These developments forced the country to reconsider its development strategy away from the “Ujamaa” policy (Bilame 2003). In response to declining economic performance, Tanzania launched its first and self-guided National Economic Survival Programme (NESP) in 1981. It was a short-term policy measure to rescue the economy from the hardships while searching for a lasting solution. The objective of this programme, among other issues, was to liberalise the economy by restructuring the major sectors of the economy; however, NESP failed because of retaining “Ujamaa” economic policies.

It was not until the financial year 1984/85 that Tanzania launched its first significant reform in liberalising the economy. The policy of “Ujamaa” started changing towards a liberalised free-market economy. The reform package

contained the following main policy measures (Wobst, 2001):

- Agricultural producer prices were raised by 46-55 per cent;
- Cooperative unions for crop marketing were introduced;
- Tanzanian shilling was depreciated by 40 per cent;
- Government wages were raised by 30 per cent;
- Domestic trade of food products was liberalised;
- Consumer price subsidies for maize were eliminated;
- The Own-Fund Import scheme, which allowed imports purchased with foreign currency deposited abroad was initiated.

Since 1984/85 the economy of Tanzania was opened to integrate with the rest of the world. Tanzania had to liberalize its economy to secure finances that were no longer available for years that could have accelerated domestic investment. During this period, significant changes concerning the liberalization of trade were made (Mkenda, 2005, Bilame, 2014).

Various policy reforms that aimed at transforming the economy from a centrally planned public-owned to a market-driven private sector-led economy were initiated in 1986. The government enacted reforms aimed to put in place laws and policies that could facilitate an enabling environment for investments for both local and foreign investors (TIC, 2012).

In February 1990, the government adopted a National Investment Promotion Policy and enacted the National Investment Promotion and Protection Act (NIPPA) of 1990 to enhance the investment climate (Bilame, 2014). Furthermore, the government undertook several measures to improve investments.

2.2 The Brief on Tanzania Economy Trend from the 2000s to Date

For the early years of the 2000s improved economic performance at the macro-level was sustained over the period. GDP growth rate consistently rose to reach 6.2 per cent in 2002 (Bilame, 2003). The National Accounts estimates show that the growth rate dropped to 5.6 per cent in 2003 due to drought that led to reduced food supplies and decreased power supply (URT, 2005). In 2004 there was a remarkable rise record of 6.7 per cent GDP growth rate (URT, 2006). During the same period, inflation was under control. The annual inflation rate was 4.3 per cent in 2003 compared to 6 per cent in 2000 (URT, 2005; URT, 2006). Foreign reserves reached 8.9 “months of imports” compared to 6.3 “months of imports” in 2000. At the end of March 2004, the reserves could cover imports of goods and services for about 8 months, which was above the target of 6 months (URT, 2006).



Increases in investments in infrastructure such as roads, telecommunications, mining and tourism were recorded owing to increased inflows of foreign direct investments and domestic revenue efforts (URT, 2006). Progress was also noted in the social services and public support services. Significant performance improvement was further evident in areas such as primary education and road networks. Of course, levels of delivery of services required further improvements in quantity and quality, which called for sustained investments in all sectors (Bilame, 2003; URT, 2006).

Of recent, Tanzania has recorded the lowest level of inflation of 3.5 and 3.4 in 2018 and 2019 respectively (URT 2020). Indeed, headline inflation decreased from an annual average of 5 per cent in 2016 to 3.3 per cent in 2020 (URT 2021). Increases in investments in infrastructure such as roads, telecommunications, mining and tourism have recorded a tremendous achievement owing to increased inflows FDI and domestic revenue efforts (Bilame, 2017, URT, 2020). Furthermore, notable significant performance has been sustained in the social services delivery. As of 2019, Tanzania had 294 and 910 hospitals and health centres respectively compared to 252 and 718 hospitals and health centres respectively that existed in 2015. In totality, health facilities increased from 7,519 in 2015 to 9,104 in 2019 (URT, 2020).

3.0 Methodology

3.1 Model Specification

A linear regression model was developed with a view of capturing variables presented in the hypotheses. Thus as per the hypotheses, growth is a function of FDI, domestic investment, exports and exchange rate. The model is thus formulated as stated hereunder:

$$Y = f(FDI, DINV, EXP, EXR)$$

Y denotes economic growth, reflected in GDP growth. FDI stand for Foreign Direct Investment. $DINV$ represented domestic investment, and EXR denoted the exchange rate and EXP for export. The basic model for regression estimation was as follows,

$$GDP_t = \beta_0 + \beta_1 FDI_t + \beta_2 DINV_t + \beta_3 EXP_t + \beta_4 EXR_t + \epsilon_t \dots \dots \dots (1)$$

Where β 's = coefficients of the variables, ϵ = error term. Thus, equation 1 had to be transformed into natural logarithm form as shown hereunder:

$$\ln GDP_t = \beta_0 + \beta_1 \ln FDI_t + \beta_2 \ln DINV_t + \beta_3 \ln EXP_t + \beta_4 \ln EXR_t + \epsilon_t \dots \dots \dots (2)$$

Where:

$\ln GDP_t$ Natural logarithm of economic growth

$\ln FDI_t$ Natural logarithm of inflow of Foreign Direct Investment
 $\ln DINV_t$ Natural logarithm of domestic investment
 $\ln EXP_t$ Natural logarithm of export and
 $\ln EXR_t$ Natural logarithm of the exchange rate.

It should be noted that economic growth expressed as GDP has been used as a dependent variable while Foreign Direct Investment (FDI), Domestic Investment ($DINV$), Export (EXP) and Exchange Rate (EXR) have been used as the independent variables.

3.2 The Data

Secondary time series data for the period 1980-2020 were collected from different sources. Data for the GDP which are in terms of annual growth rate and FDI inflows were obtained from the United Nations Conference on Trade and Development (UNCTAD) Handbook of Statistics (various issues). Data for export, domestic investment and exchange rate were obtained from the Bank of Tanzania (BOT).

3.3 Unit Root Test

Regression of time series requires to mean, variance and covariance to be constant for stationary data. Non-stationary data indicate that mean, variance and covariance are not constant. The unit root test enables the study to avoid spurious regressions. In economic analysis, spurious regression results are termed to be invalid and cannot be used for policy analysis. This implies that in spurious regression R -square is inflated and often close to one while the t -statistics ratios do not follow the t -distribution. Unit root test was carried out to test for stationarity of the variables. Augmented Dickey-Fuller (ADF) and Phillips-Perron unit root tests were applied.

3.4 Cointegration Test

The long-run equilibrium relationship between the variables was tested using the cointegration test. If dependent and independent variables are individually non-stationary but their residual (combination) is stationary, those variables are said to be cointegrated (Gujarati, 2004). A cointegration test can be thought of as a pre-test to avoid spurious regression situations. That is non-stationary time series data are said to be cointegrated if they can be transformed into a single series that exhibited stationarity (Engle and Granger, 1987).

To this end, the Johansen maximum likelihood estimation procedure was applied by this study to test for cointegration. Johansen cointegration test had the following advantages; first and foremost, it could detect the presence of multiple cointegrating vectors; but second, little attention was paid as to whether the explanatory variables were exogenous or endogenous since that was the Vector Autoregressive (VAR) based technique.



4.0 Findings and Discussion

4.1 Results

Before conducting data analysis, it is crucial to understand the properties of each variable by generating descriptive statistics. This helped to understand how the variables behave. Table 4.1 presents the mean, median, minimum, maximum, standard deviation, Skewness and Kurtosis tests for each variable.

Table 4.1: Descriptive Statistics

	lnGDP	lnFDI	lnDINV	lnEXP	lnER
Observation	40	40	40	40	40
Mean	1.398176	9.578376	3.216884	9.6435	5.86115
Std. Deviation	0.733561	7.052057	0.293358	29.762	1.8247
Variance	0.538112	49.73151	0.086059	885.83	3.32988
Minimum	-0.693147	-13.6	2.579459	-32	2.11986
Maximum	2.135822	21.188	3.570124	155.1	7.71592
Skewness	-1.653255	-1.38783	-0.82381	3.1533	-1.0379
Kurtosis	4.906028	6.634525	2.570562	16.303	2.61388

Source: STATA Estimations

As per Table 4.1, exports (EXP) had a larger standard deviation among all the variables, which suggested that exports were highly volatile as compared to other variables. The skewness/Kurtosis test for normality is applied to the data to test the normality of each variable, as shown in Table 4.1. The test involves testing the null hypothesis that the variables follow normal distribution against an alternative hypothesis which states that the variables follow the non-normal distribution. The test confirms that economic growth (GDP), foreign direct investments (FDI), domestic investments (DINV), the exchange rate (EXR) and exports (EXP) are normally distributed.

4.1.1 Unit Root Tests

The unit root test was used to investigate the stationarity of time series variables, through the null hypothesis that all variables have a unit root, meaning that they are non-stationary, against the hypothesis that no unit root, meaning that time series are stationary at the level variables. The Augmented Dickey-Fuller (ADF) and Phillips-Perron unit root tests were carried out in this study. Tables 3.2 and 3.3 present the results of unit root tests.

Table 4.2: Unit Root Test Results (variables level)

Variable	Augmented Dickey-Fuller		Phillips-Perron	
	Test Statistics	Critical value at 5%	Test Statistics	Critical value at 5%
<i>LNGDP</i>	-2.407	-2.972	-2.416	-2.972
<i>LNFDI</i>	-1.549	-2.972	-1.738	-2.972
<i>LNDINV</i>	-1.787	-2.972	-2.016	-2.972
<i>LNEXP</i>	-4.443	-2.972	-4.439	-2.972
<i>LNER</i>	-2.355	-2.972	-2.170	-2.972

Source: STATA Estimation

Table 4.3: Unit Root Test Results (first difference)

Variable	Augmented Dickey-Fuller		Phillips-Perron	
	Test Statistics	Critical value at 5%	Test Statistics	Critical value at 5%
<i>DFFlnGDP</i>	-6.627	-2.975	-6.674	-2.975
<i>DFFlnFDI</i>	-4.866	-2.975	-5.123	-2.975
<i>DFFlnDINV</i>	-5.315	-2.975	-5.351	-2.975
<i>DFFlnEXP</i>	-8.160	-2.975	-8.988	-2.975
<i>DFFlnER</i>	-4.162	-2.975	-4.188	-2.975

Source: STATA Estimations

From Table 4.3, the results reveal that export (EXP) is stationary and all other variables that are; economic growth (GDP), foreign direct investment (FDI) and exchange rate (ER) had a unit root or are non-stationary at the level of the variable. This is because the computed absolute values of the *tau* statistics do not exceed the ADF critical *tau* values, which leads us not to reject the null hypothesis that there is a unit root or that the time series are non-stationary. The same applied to the Phillips-Perron test whereby the computed absolute values of the *tau* statistics do not exceed the DF critical *tau* values. We used two tests for comparison purposes, as Phillips-Perron (PP) test uses a non-parametric approach while the ADF test uses parametric measures to take care of the serial correlation (Gujarati, 2004).

On the other hand, Table 4.3 shows that all variables (GDP, FDI, DINV, EXP and ER) became stationary after the first difference as the computed absolute values of the *tau* statistics exceeded the ADF critical *tau* values, which led us to reject the null hypothesis. The same applied to the Phillips-Perron test whereby the computed absolute values of the *tau* statistics exceed the DF critical *tau* values.

Conclusively, testing the unit root in the time series variable was done and the time series variables were found non-stationary i.e., have a unit root (at level variable). Due to the presence of unit root (non-stationary) in almost all variables,



first, differencing was employed in all variables to make them stationary. After first differencing the time series variables were all found stationary at the difference variable as shown in Table 4.3. This as well, means that all variables are integrated of order one, $I(1)$.

4.1.2 Cointegration Test

Based on the results in Table 4.3, and according to Engel and Granger (1987), if two-time series variables are integrated of order one, $I(1)$, there could be a linear combination between them which may be integrated of order zero, $I(0)$ (Green, 2002). Therefore, this leads to testing for the presence of cointegration in the variables. The test was conducted by using the Johansen cointegration test. Table 4.4 presents the results of the test.

Table 4.4: Results for Johansen tests for Cointegration

Max rank	Parms	LL	Eigenvalue	Trace statistic	5% Critical value
0	30	-	-	75.7265	68.52
1	39	633.74022	0.60626	42.1724*	47.21
2	46	616.96318	0.42983	21.9468	29.68
3	51	606.85039	0.30560	8.8176	15.41
4	54	600.28577	0.18784	1.3276	3.76
5	55	596.54081	0.03621	-	-
		595.87699	-	-	-

Source: STATA Estimation

From Table 4.4, the test revealed that there is cointegration and there is only one maximum rank of this cointegration. This is because the first significant values where trace statistic is less than the critical value at 5 per cent were found at a maximum rank of one. This suggested that there is one cointegrating equation that calls for running an Error Correction Model (ECM). During the process all lags of the variables were dropped due to their insignificance, the estimates for the final ECM are presented in Table 4.5.

4.1.3 Error Correction Model (ECM)

The ECM for this study followed the Engle-Granger two-step procedures because there is only one cointegrating vector. A regression with level variables (in log form) was run using the OLS method to obtain the residual for a long-run relationship or an equilibrium error (Gujarati, 2004).

Table 4.5: Results: Unit Root Test for the Long Run Relationship Residual

Residual	Augmented Fuller Test Statistics	Dickey- Fuller Critical Value at 5%	Phillips-Perron Test Statistics	Phillips-Perron Critical Value at 5%
Res (ECT)	-3.617	-2.975	-3.596	-2.975

Source: STATA Estimation

Table 4.5 shows that cointegration existed and Error Correction Term (ECT) or residual was stationary because the absolute value for both Augmented Dickey-Fuller and Phillips-Perron unit root tests were greater than critical values at five per cent. Cointegration means that despite being individually non-stationary, a linear combination of foreign direct investment, domestic investment, export and exchange rate are stationary indicating a long run or equilibrium relationship between them. Because of the presence of cointegration, it was necessary to apply ECM to check the short-run relationship of the variables and how they influence economic growth.

Table 4.6: Impact of FDI on Economic Growth in Tanzania: An Error Correction Model

Variables	Coeff.	Std.Err	T	P> t
dfflngdp	-.2606646	.1187154	-2.20	0.038
L2				
dffflndi	.0325057	.0153326	2.12	0.044
L1				
dfflndinv	-1.081934	.4012234	-2.70	0.012
L3				
dfflnexp	.0058107	.0014829	3.92	0.001
dfflnexp	-.720591	.2553186	-2.82	0.009
err				
L1	-.695332	.329722	0.18	0.0002
cons	.1803797	.0724479	2.49	0.020

Number of observations 34

Prob> F0.0013

R-squared 0.6026

Table 4.6 shows the results of ECM that. Holistically, the model is significant at 5 percent level ($p > \chi^2 = 0.0013$). Furthermore, the model has a good fit as highlighted by the coefficient of determination (R-squared). The parameters in the model all explain the economic growth of about 60 per cent. This implied that 60 per cent of the total variation in economic growth is explained by all variables.

4.2 Discussion

Results from the error correction model presented in Table 4.6 show that FDI is positively related to economic growth as stated in the hypothesis and therefore this study failed to reject the hypothesis. This implies that GDP growth expands as FDI increases. In that regard, FDI inflows play a crucial role in stimulating economic growth.

Domestic investment is negatively related to economic growth and statistically significant, implying that FDIs have no 'crowding in effect' in influencing the domestic investment. To this end, FDI crowds out domestic investments in developing countries due to advanced technology from developed countries. Indeed, that is what has been happening in Tanzania that FDIs have not that much having 'crowding in effect' in Tanzania.

The exchange rate is positively related to economic growth which leads to the appreciation of a domestic currency. This implies that appreciation (overvaluation) of Tanzanian shillings may affect Tanzania's economy negatively while



depreciation may improve economic growth. This is because depreciation makes Tanzania's export cheaper which increases demand for domestically produced goods and thus, stimulates economic growth. Appreciation of Tanzania's shillings makes export expensive which may reduce the demand for Tanzania's export hence retards the economic growth.

Concerning comparison with other studies, this study concludes that FDIs affect economic growth positively in the long run. The results are similar to the results by Borensztein *et al.* (1998) for cross-country studies and Olayiwola and Okodua (2013) for Nigeria. Both studies concluded that FDIs have a positive effect on economic growth in the long run. Nevertheless, the findings of this study contradict the findings of Carkovic and Levine (2003) for cross-country studies and Awe (2003) for Nigeria, who found no positive influence of FDI on economic growth. But again, Titarenko's (2006) study concluded that FDIs "crowd out" domestic investments in Latvia in the long run while Göçer *et al.* (2013) concluded that even though FDIs have crowding in effect in Asian, Latin American and Caribbean countries, they were posing 'crowding out effect' in the African developing countries. These results concur with the results of this study that FDIs were somewhat posing a 'crowding out effect' on domestic investments in Tanzania.

5.0 Conclusion and Policy Implications

5.1 Conclusion

This study attempted to shed light on an empirical analysis of FDIs and Economic performance in Tanzania from 1980 to 2020. The idea of carrying out this study emanated from the fact that Tanzania has been one of the leading countries in Africa that attract substantial inflows of FDIs each year, at least before the outbreak of COVID 19. But again, the empirical studies that have been reviewed on the subject matter remain inconclusive about the impact that FDIs have had on the country's economic growth trend. To this end, this study aimed at exploring different channels through which FDIs affect economic growth in Tanzania.

For normalization purposes, all the variables were transformed into a natural logarithmic state. The unit root test was undertaken using both the Augmented Dickey-Fuller test and Phillips-Perron tests for stationarity. All variables were non-stationary (have unit root), and after first differencing all variables were stationary except for the export variable which was not stationary.

In the test for a long-run relationship between variables, by conducting cointegration of series using the Engle-Granger Cointegration test, the variables were found to be cointegrated. The presence of cointegration led to conducting an ECM test to establish the short-run dynamics of the variables. Post estimation was performed and the results revealed that the model was well fitted and correctly

specified with no serious problem of omitted variables, along with the absence of multicollinearity, heteroscedasticity and serial correlation problem.

The study has come up with results that show FDIs to have a positive effect on economic growth and thus support the hypothesis that FDIs have a positive impact on economic growth and exports. Nevertheless, the study also came up with mixed results that show that FDIs "crowd out" domestic investments in Tanzania both in the short and long run. To that effect, the study rejects the hypothesis that states that FDIs cause 'crowding in' of domestic investments. 'Crowding out effect' is because MNCs have firm-specific knowledge over domestic firms. At this juncture, it may be pointed out that all the hypotheses have been proved to be significant in explaining Tanzania's economic growth except for the hypothesis that stated that FDIs cause 'crowding in' of domestic investments. FDIs are 'crowding out' domestic investments. This may be because domestic investors fail to compete with foreign investors who poses advanced technologies.

5.2 Policy Implications

Based on the research findings of this study some informed decisions making by policymakers are highlighted hereunder:

- ✓ Since FDIs are found to have a positive effect on economic growth, the government should increase the momentum of putting further an enabling environment that attracts more FDIs in Tanzania.
- ✓ It was a critical moment for the Tanzania Investment Centre (TIC) to be given more mandates to play a facilitative role that can increase investment projects to realize investment plans in the country. To that effect, the government should allocate sufficient budgetary allocation to TIC and in a way enable many investment projects to take off. Further to that, TIC should be equipped with enough technical human resources capable of performing their duties.
- ✓ Since the study has come with results that show that exports have a positive impact on economic growth, then the focus should be to put more emphasis on an export-led economy composed of exports with added value. That is exports should be composed of not primary products but rather products whose values have been added on to attract higher prices on them in foreign markets.
- ✓ FDIs inflows as per the findings of this study 'crowd out' domestic investments. To that effect, government support to encourage domestic firms to become innovative and equally compete with foreign firms to accelerate Tanzania's economic growth was indeed called for.



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