

Investment and Economic Growth: An Empirical Analysis for Tanzania

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Abstract : This paper analyzes the causal effect between domestic private investment, public investment, foreign direct investment and economic growth in Tanzania during the 1970-2014 period. The modified neo-classical growth model that includes control variables such as trade liberalization, life expectancy and macroeconomic stability proxied by inflation is used to estimate the impact of investment on economic growth. Also, the economic growth models based on Phetsavong and Ichihashi (2012), and Le and Suruga (2005) are used to estimate the crowding out effect of public investment on private domestic investment on one hand and foreign direct investment on the other hand. A correlation test is applied to check the correlation among independent variables, and the results show that there is very low correlation suggesting that multicollinearity is not a serious problem. Moreover, the diagnostic tests including RESET regression errors specification test, Breusch-Godfrey serial correlation LM test, Jacque-Bera-normality test and white heteroskedasticity test reveal that the model has no signs of misspecification and that, the residuals are serially uncorrelated, normally distributed and homoskedastic. Generally, the empirical results show that the domestic private investment plays an important role in economic growth in Tanzania. FDI also tends to affect growth positively, while control variables such as high population growth and inflation appear to harm economic growth. Results also reveal that control variables such as trade openness and life expectancy improvement tend to increase real GDP growth. Moreover, a revealed negative, albeit weak, association between public and private investment suggests that the positive effect of domestic private investment on economic growth reduces when public investment-to-GDP ratio exceeds 8-10 percent. Thus, there is a great need for promoting domestic saving so as to encourage domestic investment for economic growth.

Keywords : FDI, public investment, domestic private investment, crowding out effect, economic growth

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