THE EFFECT OF FOREIGN DIRECT INVESTMENTS ON ECONOMIC GROWTH IN KENYA

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DECLARATION

This research project is my original work and has not been submitted for examination in any other university.

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DEDICATION

This work is dedicated to the Almighty God for guidance and enabling me to complete this task. I dedicate this project to my parents and friends for their unwavering support, encouragement and their unconditional guidance.

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LIST OF ABBREVIATION

ARDL	Autoregressive Distributed Lag
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFS	International Financial Services
IMF	International Monetary Fund
MNEs	Multinational Enterprises
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
PPF	Production Possibility Frontier
R & D	Research and Development
SAARC	South Asia Association of Regional Cooperation
TNCs	Transnational Corporations
UNCTAD	United Nations Conference on Trade and Development
VECM	Vector Error Correction Model

ABSTRACT

This study attempts investigates the effect of Foreign Direct Investments (FDI) on economic growth in Kenya. International Monetary Fund (1977) defines FDI as investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise. The study used descriptive research design which is used when the problem has been specifically defined and where the researcher has certain issue to be described by the respondents about the problem. Secondary data was collected for the period between1981 and 2010. Secondary data of FDI was collected from central bank of Kenya Databases, the world periodical and economic survey reports and websites, the Treasury periodical financial reports and periodicals, National Bureau of Statistics-the periodical economic survey and outlook reports and International Monetary Fund (IMF) periodical and economic survey reports and websites while economic growth data was captured from the Central Bank of Kenya quarterly for the last 10 years, 2003- 2013. Microsoft excels package was used to analyze the data to obtain the descriptive statistics (mean and standard deviation) and correlation and multiple linear regression model fitted to explain the relationship between variables. Findings were presented in tables and graphs. The Pearson correlation was computed for Gross Domestic Product (GDP), FDI, Inflation Rate and Foreign Debt resulting in a weak negative relationship. These findings have led to the conclusion that there is a small impact brought about by FDI to Kenyan economic growth. The Kenyan government should embrace policies that aim to attract more FDI while micromanaging the same to avoid the negative impact of FDI on local firms such as crowding out

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

For Kenya and other developing countries, attracting Foreign Direct Investments (FDI) has been a key aspect of its outward-oriented development strategy, as investment is considered a crucial element for output growth and employment generation (Kayonga, 2008). The last decade of the 20th century has seen major shifts in the size and composition of cross-border capital flows into developing countries. Net debt flows have become less and less important. Portfolio flows have become firmly established. FDI has come to swamp all other financial flows (World Development Report, 2000).

FDI provides a major source of capital which brings with it up-to-date technology contributing to economic growth. It would be difficult to generate this capital through domestic savings, and even if it were not, it would still be difficult to import the necessary technology from abroad, since the transfer of technology to firms with no previous experience of using it is difficult, risky, and expensive (Duce and Maitena, 2003).

Over a long period of time FDI has created many externalities in the form of benefits available to the whole economy which the host countries cannot appropriate as part of their own income. These include transfers of general knowledge and of specific technologies in production and distribution, industrial upgrading, work experience for the labor force, the introduction of modern management and accounting methods, the establishment of finance-related and trading networks, and the upgrading of

telecommunications services. FDI in services affects the host country's competitiveness by raising the productivity of capital and enabling the host country to attract new capital on favorable terms.

It also creates services that can be used as strategic inputs in the traditional export sector to expand the volume of trade and to upgrade production through product and process innovation. By altering a country's comparative advantages and improving its competitiveness through technology transfer and the effects of myriad externalities, foreign as well as domestic investments can alter a country's economic volume and pattern of trade in many income- enhancing directions (Ramirez, 2006).

1.1.1 Foreign Direct Investments

In large international institutions, there are different definitions of Foreign Direct Investments (FDI). The International Monetary Fund (1977) defines FDI as: investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise.

While Organization for Economic Co-operation and Development (OECD) benchmark definition of FDI identifies FDI's objective is to obtain a lasting interest by a resident entity ("direct investor") in one economy other than that of the investor ("direct investment enterprise"). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital

transactions between them and among affiliated enterprise; both incorporated and unincorporated (OECD, 1996).

Foreign direct investment is a particular type of foreign capital, as opposed to domestic investment. Fu (2000) argues that it does not include loan capital provided by international organizations, foreign governments, or private commercial banks. Nor does it automatically include portfolio investments such as stocks and bonds purchased by foreigners. What makes investment "direct" as opposed to other forms of foreign capital is the concept of managerial control over an enterprise in which foreign capital participates (Fu, 2000). Geographer Roger Hayter (1997) argues that FDI comprises activities that are controlled and organized by firms (or groups of firms) outside of the nation in which they are headquartered and where their principal decision makers are located. In the context of the manufacturing sector, FDI is conventionally thought of in terms of branch plant or subsidiary company operations that are controlled by parent companies based in another country.

FDI is a key element in international economic integration. FDI creates direct, stable and long- lasting links between economies. It encourages the transfer of technology and expertise between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment; it can be an important vehicle for development (OECD, 2012). FDI inflows have in general been recognized as beneficial to economic growth in developing countries in the sense of improvement of productivity level (Zhao and Zhang, 2010),lowering the level of unemployment (Chaudhuri et al., 2006), expansion of domestic investment, transfer of advanced

technologies from abroad, increasing competition in the host country, and increasing export values and foreign exchange earnings (Ram and Zhang, 2002).Therefore, most developing countries have actively tried to attract FDI especially since the 1980s.

According to the definition, the existence of such long-term influence should be assumed when voting shares or rights controlled by the multinational firm amount to at least 10 percent of total voting shares of rights of the foreign firm. Aggregate FDI flows are the sum of equity capital, reinvested earnings, and other direct investment capital; hence, aggregate FDI flows and stocks include all financial transfers aimed at financing of new investments, plus retained earnings of affiliates, internal loans, and financing of cross-border mergers and acquisitions. FDI flows can be observed from the perspective of the host economy, which records them as inward FDI along with other liabilities in the balance of payments, or from the perspective of the home economy, which records them as Outward FDI, a category of assets. The sum of all direct capital owned by non-residents in a given country *j* in a certain time period *t* constitutes the existing stock of FDI at that time. We will refer to the stock of foreign direct capital as K_{it}. Hence, in each period FDI, is the per-period increase in the stock of foreign direct capital, $FDI_{it} = K_{it} - K_{it}$ in country.

These measures can be sufficiently accurate in the short run. However, the value of the capital stock changes over longer periods, causing problems with the adjustment of its valuation. Over 20 years, the value of the stock of FDI at current prices may become three times as large as its historical value. For example, (Ihrig and Marquez, 2006) show that if one simply adds up net direct investment flows from 1982 to 2004, then the United States has net claims on foreigners of approximately $250

billion; whereas, if one adjusts the values of assets and liabilities for inflation and changes in exchange rates (current cost), then net claims on foreigners in 2004 soar to almost $600 billion. The difference between these two measures of the net direct investment position results from valuation adjustments over this time period. Another way to adjust the value is to calculate the net position at market value, a procedure that brings the net direct investment position to $500 billion in 2004. (Contessi and Weinberger, 2009).

1.1.2 Economic Growth

Economic Growth represents the expansion of a country's potential Gross Domestic Product(GDP) or national output. Put differently, economic growth occurs when a nation's Production Possibility Frontier (PPF) shifts outward. A closely related concept is the growth in per capita output because this leads to rising average incomes (Samuelson and Nordhaus, 2010).

One of the key contributors to economic growth is technology. Improved technology leads to increased production, which means more wages and more profits for employees and investors respectively. Changes or advancements in technology have been credited with much of the steps that the world economy has made so far. Another contributor that is perhaps worth taking note of would be globalization. Globalization has led to expanded markets, more opportunities for employment as well as investment, and more efficiency due to competition (OECD, 2012).

Positive economic growth signals a wealthier economy, and increased prosperity. There is increased production, which means increased profits for the production

companies. Increased production also translates to increased tax collection for the government and, reduced unemployment levels, and better prospects for the economy. Increase in economic growth shows increase in social welfare and long-term economic development, and that is the reason why the government is concerned about finding ways to promote the economic growth of the country, for which it devises many plans and policies. Looking at economic theory, we can find many variables such as human capital, physical capital, technology, etc. that are effective on economic growth.

In the past two decades, FDI has been studied as an important factor affecting growth and development. However, the effect of FDI on the host country's economic growth has been most intensively debated in the literature because of its controversial character (Voinea, 2007).Of more importance is the growth of the ratio of GDP to population (GDP per capita), which is also called per capita income. An increase in growth caused by more efficient use of inputs is referred to as intensive growth. GDP growth caused only by increases in inputs such as capital, population or territory is called extensive growth.

Economic growth is the sustained increase in welfare of an economy-nation, region, city- together with the ongoing changes in that economy's industrial structure; public health, literacy, and demography; and distribution of income. In the long run, as this economic transformation evolves so do social, political, and cultural norms. Societies change profoundly and multi dimensionally, as economic performance improves. To measure economic growth is to quantify this increase in welfare and to endow with numerical precision these large-scale economic and social changes. Given the breadth

of possibilities, it is impossible to undertake this measurement exercise without guidance-what can be pared away, what is essential-from some view on the causes of growth. (Pyle, 2001)

1.1.3 Effects of Foreign Direct Investments on Economic Growth

FDI affects economic growth through two principal mechanisms. The first mechanism, often referred to as the "direct effect" in the literature, relates to the net contribution FDI makes to capital stock by increasing the host country's savings and investments and expanding the variety of goods and production technologies (i.e., capital equipment). In particular, FDI is assumed to stimulate domestic savings and induce technological progress through innovation and incorporation of advanced technologies in the production process. Given the assumed superior productive capacity of foreign-controlled firms Multinational Enterprises(MNEs) which are vertically and horizontally diversified and superior technology and knowledge vis-a-vis enterprises in industrializing economies (Dicken, 2003), FDI is considered a direct source of foreign technology transfer and productivity growth (Bijsterbosch and Kolasa, 2009). It is also considered to have the cheapest and the most direct effect on industries' productive capacity and efficiency (Damijan et al., 2005).

The second mechanism relates to the "indirect effects" of FDI. Given the assumed superior technological proficiency of foreign affiliates, FDI is expected to contribute to the knowledge stock of a host country by encouraging local diffusion of knowledge and innovation. A wide range of positive externalities are linked to collaboration with and the presence of foreign MNEs, such as technology and knowledge spillovers. The mechanism through which knowledge and innovation are

diffused to local firms is, though complex, generally considered intrinsic in the demonstration-imitation effect, the competition effect, the linkage effect, and the training effect (Damijan et al., 2008).

The demonstration effect refers to learning (copying) superior technologies through simple MNE presence on the market/within the local industry. The competition effect refers to incentives to adopt superior technologies to keep up with competitors; the linkage effect refers mostly to increasing productive efficiency through vertical interaction (i.e., the MNE and supplier relationship) but also through technological collaboration between foreign and domestic firms; and the training effect refers to employing people with experience in foreign firms, or direct employee training. Overall, technology and knowledge spillovers are considered permanent and the most important indirect effects of FDI on output because they augment the existing stock of knowledge and technological capabilities of the recipient economy.

The empirical evidence is not unanimous; however, available evidence for developed countries seems to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms (Globeram, 1979). The results for developing countries are not so clear, with some finding positive spillovers (Blomstrom, 1986) reporting limited evidence. Still others find no evidence of positive short run spillover from foreign firms. Some of the reasons adduced for these mixed results are that the envisaged forward and backward linkages may not necessarily be there (Aitken et.al.1997).

Further, the role of FDI in export promotion remains controversial and depends crucially on the motive for such investment (World Bank, 1998). The consensus in the literature appears to be that FDI spillovers depend on the host country's capacity to absorb the foreign technology and the type of investment climate (Obwona, 2004).Curiously, the empirical evidence of these benefits both at the firm level and at the national level remains ambiguous. De Gregorio (2003), while contributing to the debate on the importance of FDI, notes that FDI may allow a country to bring in technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy. FDI may also bring in expertise that the country does not possess, and foreign investors may have access to global markets. In fact, he found that increasing aggregate investment by 1 percentage point of GDP increased economic growth of Latin American countries by 0.1% to 0.2% a year, but increasing FDI by the same amount increased growth by approximately 0.6% a year during the period 1950-1985, thus indicating that FDI is three times more efficient than domestic investment.

1.1.4 Foreign Direct Investments and Economic Growth in Kenya

For a long period of time Kenya has had the best economy in the East African region having the advantage of a more diversified economy. At the beginning of the 1970s, Kenya was a big destination for many investors seeking to establish presence in East and Southern Africa. According to UNCTAD FDI grew steadily through the 1970s as Kenya was a prime choice for foreign investors. Economist argue that FDI can bridge the gap between developed and developing nations or host countries and provide greater opportunities for growth in the host markets (Romer, 1993). Relatively high level of development, good infrastructure, market size, growth and openness of FDI

at a time when other countries in the region had relatively closed the regimes all contributed to Transnational Corporations (TNCs).

Key factors to growth are, Human Resources and international transportation infrastructure of which are two key aspects of Kenya's attractive investment environment. Kenya has the highest literacy rates resulting in a high level of qualified upper level skilled labor and staff. The large labor supply fairly contributed to low wage levels. Flexible employment regulations make workforce environment comparatively easy for companies in Kenya Kenyan firms also benefit from access to well-developed sea shipping and airfreight services. Kenya's Export processing zones (EPZs) strengthen the operating environment for zone based industries as these areas have comparatively good electrical, water and telecommunications and connections. FDI plays a significant role in the growth and development of the Kenyan economy through technological spillovers, job creation improved managerial skills, productivity international production networks and access to external networks. The role of FDI as a source of capital cannot be undermined specially in the backdrop of the decline in official development assistance in the 1990s.

According to a study done by Daniel O Abala, Kenya has had inconsistent trends of FDI inflows starting with the 1970-1980 period FDI started at a low of around US$ 10 million a year in the early 1970s before peaking at US$ 60 million by 1979-80. The country received relatively large capital inflows partly driven by rapid expansion in the agricultural sector, expansionary fiscal and monitory policies, sustainable budget deficit and the import substitution industrialization strategy. This involved overvalued exchange rates, import tariffs, quantitative restrictions and import

licensing. FDI inflows in the period 1981-1999 averaged only US$ 22million per annum.

However after 1980s, Kenya's economy was characterized by deterioration in economic performance, c corruption and bad governance. Inconsistencies in the implementation of economic policies and structural reform measures as well as deterioration of public service and infrastructure ensured decades of low level of FDI inflows.

1.2 Research Problem

The economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spillovers. Romer (1993), for example, argues that there are important "idea gaps" between rich and poor countries. He notes that foreign investment can ease the transfer of technological and business know-how to poorer countries. These transfers may have substantial spillover effects for the entire economy. Thus, foreign investment may boost the productivity of all firms, not just those receiving foreign capital (Rappaport, 2000). While there are sound conceptual reasons for believing that FDI can ignite economic growth, the empirical evidence is divided (Carkovic and Levine, 2002).

With the drying-up of commercial bank lending to developing economies in the 1980s, most countries eased restrictions on foreign direct investment (FDI) and many aggressively offered tax incentives and subsidies to attract foreign capital (Aitken and Harrison, 1999). Along with these policy changes, there was a surge of non-

commercial bank private capital flows to developing economies in the 1990s. Private capital flows to emerging market economies exceeded $320 billion in 1996 and reached almost $200 billion in 2000. Even the 2000 figure is almost four times larger than the peak commercial bank lending years of the 1970s and early 1980s. Furthermore, FDI now accounts for over 60 percent of private capital flows. While the explosion of FDI flows is unmistakable, the growth effects remain unclear.

Firm-level studies of particular countries often find that FDI does not boost economic growth and these studies frequently do not find positive spillovers running from foreign-owned to domestic-owned firms. Aitken and Harrison's (1999) influential study found no evidence of a positive technology spillover from foreign firms to domestically owned ones in Venezuela between 1979 and 1989. Similarly, (Germidis, 1977), (Haddad and Aitken, 1993), and Mansfield and Romeo (1980) found that FDI did not accelerate growth. Taken together, firm-level studies do not lend much support for the view that FDI accelerates overall economic growth. (Carkovic and Levine, 2002).

There are great gaps in the statistics available, from both investor and recipient countries, on foreign investment. Partly as a result of business secrecy and partly owing to a lack of official scrutiny, most developed countries do not publish comprehensive information on the foreign operations of their firms. Even the United States, which has by far the best coverage of all aspects of business activity, is found wanting (US Tariff Commission, 1973).

Therefore, from these previous studies, the evaluation of the relationship between FDI and economic growth specific to Kenya is not addressed, including establishing the impact of either variable to the other with a specific focus on Kenya. This research therefore aims at addressing the relationship puzzle, thus answering the following research question: What is the effect of FDI on economic growth in Kenya?

1.3 Research Objective

To establish the effect of FDI on economic growth in Kenya.

1.4 Value of the Study

This study is significant in that it shows the importance of FDI to the economy. FDI stimulates domestic growth, creates employment opportunities, and aids policy makers in developing investment strategy policies and developing requisite institutional framework necessary to market Kenya as an ideal foreign investment destination.

FDI acts as a guide to policy makers and academicians since it adds knowledge to researchers in this field of study.

The government would also benefit from this study as it would be able to understand the real impact of FDI and its importance on economic growth. It would also contain the political situation in the country which has for a long time negatively affected the exchange rates and extension of FDI inflows into the country.eg the 2007-08 post-election violence

The results of this study will encourage policy makers to design follow up policies in developed, developing and least developed countries. The results would also provide strong evidence to policy makers to work for a better institutional quality for growth and development.

CHAPTER TWO

LITERATURE REVIEW

2.1Introduction

This chapter discusses texts of scholarly papers relevant to FDI and economic growth with the objective of understanding substantive findings as well as theoretical and methodological contributions. Secondary sources have been used in all sections. Section 2.2 examines the theoretical review; Section 2.3 examines determinants of Economic growth, in Section 2.4 we look at the empirical review and finally Section 2.5 which is the summary of Literature review.

2.2Theoretical Review

This essay starts with a discussion of the theoretical framework to elaborate how different theories have addressed the issue of FDI and economic growth. Theoretical studies on FDI and economic growth have led to a better understanding of the economic mechanisms and the behavior of economic agents, both at micro and macro level.

2.2.1 The Neoclassical Theory

According to neoclassical theory (Bergten, et al., 1978) FDI influences income growth by increasing the amount of capital per person. It spurs long-run growth through such variables as (research and development (R&D) and human capital. Through technology transfer to their affiliates and technological spillovers to unaffiliated firms in the host economy, Multi-National

Corporations (MNCs) can speed up the development of new intermediate product varieties, raise product quality, facilitate international collaboration on Research &Development, and introduce new forms of human capital (Ikiara, 2003). Bajona& Kehoe (2006) discussed explanations of multinational production based on neoclassical theories of capital movement and trade within the Hecksher-Ohlin framework. However, they criticize these theories on the basis that they were founded on the assumption of existence of perfect factor and goods markets and were therefore unable to provide satisfactory explanation of the nature and pattern of FDI. In the absence of market imperfections, these theories presumed that FDI would not take place. Nevertheless, they argue that the presence of risks in investing abroad implies that there must be distinct advantages to locating in a particular host country.

2.2.2 Endogenous Growth Theory

Endogenous growth models (Romer ,1993 ; Lucas, 1988; Barro and Sala-i-Martin, 1995) that highlight the importance of improvement in technology, efficiency, and productivity suggest that FDI can positively influence the growth rate in so far as it generates increasing returns in production via externalities and production spillovers. On further theoretical arguments why developing countries may not gain from FDI; Krugman, argues that the transfer of control from domestic to foreign firms may not always be beneficial to the host countries because of the adverse selection problem. FDI undertaken within a crisis situation under, "Fire Sale" may transfer ownership of firms from domestic to foreign firms that are less efficient.

This concern is particularly important to the developing countries including the Sub Saharan African countries, where, as part of privatization, state owned enterprises are sold to foreign firms simply because foreign firms have more available funds than domestic ones. As pointed out by Salz, Agosin and Mayer (1998), FDI may also "crowd out" domestic firms through unfair competition. There is also a concern that the enclave nature of many foreign owned firms and their minimal linkage to the rest of the economy could reduce the potential spillover contribution to the national economy. Moreover, the potential subsequent outflow of foreign firms' subsidiary earnings to their parent companies could also cause deterioration in the balance of payments. It is also argued that foreign corporations tend to produce inappropriate goods that are tailored to satisfy the wealthy portion of the host country's consumers, thereby increasing inequality and engaging in transfer pricing.

2.2.3 Cumulative Causation Theory

The theory of cumulative causation was developed by (Myrdal, 1957) and (Kaldor, 1970). This theory is the argument of 'cumulative causation' in which initial conditions determine economic growth of places in a self-sustained and incremental way. As a result, the emergence of economic inequalities in space is the most possible outcome.

Although there are centrifugal effects (positive spillovers) spreading growth from the more to the less advanced economies, they are incapable of bringing the system into a state of balance if market forces alone are left at work. In other words, economic policy has to come into play to correct these imbalances. In contrast to the theories mentioned above, the theory of cumulative causation has a medium term view and

often described as "soft" development theory due to lack of mathematical rigor (Plummer andTaylor, 2001).

2.2.4 New Economic Geography Theory

Similarly to the cumulative causation theory, the New Economic Geography Theory (NEG) theory asserts that economic growth tends to be an unbalanced process favoring the initially advantaged economies (Krugman, 1991; Fujita et al, 1999). However, in contrast to the former studies, this strand of literature develops a formalized system of explanations which places explicit emphasis on the compound effects of increasing returns to scale, imperfect competition and non-zero transportation costs. Central to this theory is the view that economic activity tends to agglomerate in specific places and to choose locations with a large local demand resulting in a self-reinforcing growth process. The spatial distribution of economic activity can be explained by agglomeration (or centripetal forces and dispersion/ or centrifugal forces). The former include backward and forward linkages of firms, externalities and scaled economies, while the later include negative externalities, transport costs and intensification of competition. Consequently, NEG is mainly concerned with the location of economic activity, agglomeration and specialization rather than with economic growth par say. However, regional growth outcomes can be inferred from its model.

2.3Determinants of Economic Growth

A wide range of studies have investigated the factors underlying economic growth. Using different conceptual and methodological viewpoints, these studies have placed emphasis on a different set of explanatory parameters and offered various insights to the sources of economic growth.

2.3.1 Foreign Direct Investments

FDI has recently played a crucial role of internationalizing economic activity and it is a primary source of technology transfer and economic growth. This major role is stressed in several models of endogenous growth theory. The empirical literature examining the impact of FDI on growth has provided more-or-less consistent findings affirming a significant positive link between the two (Borensztein et al., 1998; Hermes and Lensink, 2000; Lensink and Morrissey, 2006).

2.3.2 Investment

Investment is the most fundamental determinant of economic growth identified by both neoclassical and endogenous growth models. However, in the neoclassical model, investment has impact on the transitional period, while the endogenous growth models argue that investment has more permanent effects. The importance attached to investment by these theories has led to an enormous amount of empirical studies examining the relationship between investment and economic growth (Kormendi and Meguire, 1985; De Long and Summers, 1991; Levine and Renelt, 1992; Mankiw, 1992; Auerbach et al., 1994; Barro and Sala-i-Martin, 1995; Sala-i-Martin, 1997; Bond et al., 2001; Podrecca and Carmeci, 2001).

2.3.3 Innovation and Research & Development Activities

Innovation and R&D activities can have played a major role in economic progress increasing productivity and growth. This is due to increasing use of technology that enables introduction of new and superior products and processes. This role has been stressed by various endogenous growth models, and the strong relation between innovation, R&D and economic growth has been empirically affirmed by many

studies (Fagerberg, 1987; Lichtenberg, 1992; Ulku, 2004).

2.3.4 Human Capital

Human Capital is the main source of growth in several endogenous growth models as well as one of the key extensions of the neoclassical growth model. Since the term 'human capital' refers principally to workers' acquisition of skills and know-how through education and training, the majority of studies have measured the quality of human capital using proxies related to education (e.g. school-enrolment rates, tests of mathematics and scientific skills, etc.). A large number of studies have found evidence suggesting that educated population is key determinant of economic growth (Barro, 1991; Mankiw et al., 1992; Barro and Sala-I-Marin, 1995; Brunetti et al., 1998, Hanushek and Kimko, 2000). However, there have been other scholars who have questioned these findings and, consequently, the importance of human capital as substantial determinant of economic growth (Levine and Renelt, 1992; Benhabib and Spiegel, 1994; Topel, 1999; Krueger and Lindahl, 2001; Pritchett, 2001).

2.3.5 Openness to Trade

Openness to trade has been used extensively in the economic growth literature as a major determinant of growth performance. There are sound theoretical reasons for believing that there is a strong and positive link between openness and growth. Openness affects economic growth through several channels such as exploitation of comparative advantage, technology transfer and diffusion of knowledge, increasing scale economies and exposure to competition. Openness is usually measured by the ratio of exports to GDP.

There is a substantial and growing empirical literature investigating the relationship between openness and growth. On the one hand, a large part of the literature has found that economies that are more open to trade and capital flows have higher GDP per capita and grew faster (Dollar, 1992, Sachs and Warner, 1995, Edwards, 1998, Dollar and Kraay, 2000). On the other hand, several scholars have criticized the robustness of these findings especially on methodological and measurement grounds (Levine and Renelt, 1992; Rodriguez and Rodrik, 1999; Yamvakidis, 2002).

2.3.6 Economic Policies and Macroeconomic Conditions

These have, also, attracted much attention as determinants of economic performance (Kormendi and Meguire, 1985; Grierand and Tullock, 1989; Barro, 1991, 1997; Fischer, 1993; Easterly and Rebelo, 1993; Barro and Sala-I-Martin, 1995) since they can set the framework within which economic growth takes place. Economic policies can influence several aspects of an economy through investment in human capital and infrastructure, improvement of political and legal institutions and so on (although there is disagreement in terms of which policies are more conductive to growth). Macroeconomic conditions are regarded as necessary but not sufficient conditions for economic growth (Fischer, 1993). In general, a stable macroeconomic environment may favor growth, especially, through reduction of uncertainty, whereas macroeconomic instability may have a negative impact on growth through its effects on productivity and investment (e.g. higher risk). Several macroeconomic factors with impact on growth have been identified in the literature, but considerable attention has been placed on inflation, fiscal policy, budget deficits and tax burdens.

2.4 Empirical Review

The casual relationship between FDI and economic growth remains an issue of intense debate among researchers. Numerous studies have been done to demonstrate the actual relationship between FDI and economic growth of host countries, under a period of time. The researchers show the short and long run effects of FDI, how it enlarges and diversifies the economic base, and improves local skills and builds up stock of human capital resources capabilities. The studies were done in different countries and they all elaborate on the effects of FDI in the countries.it explained the negative and positive effects on different countries depending on their development stages. All researchers have different opinions; some come to conclusion that FDI has an inverse relationship to economic growth while others argue that FDI has brought more advantages and wealth to the host countries.

2.4.1 International Evidence

Borensztein et al.,(1998); Carkovic and Levine (2002); Alfaro et al.,(2003), looked at the direct effect of different types of FDI on economic growth using cross-sectional regressions with 47 countries for the period 1980-1999. The purpose of the empirical analysis was to determine whether FDI in the primary, manufacturing and service sectors exerted different effects on a country's growth. It was difficult to construct accurate and comparable measures of FDI data by sector for a broad cross section of countries over several decades particularly for developing countries. They found that FDI flows into the different sectors of the economy (namely primary, manufacturing and services) exerted different effects on economic growth. FDI inflows into the primary sector had a negative effect on growth whereas FDI inflows in the manufacturing sector had a positive and significant effect on growth.

Apergis et al., (2004) used a panel data set covering 27 transitional economies over the period 1991 to 2000 to investigate the direction of the relationship between FDI and economic growth in transitional economies by applying what they call the "novel methodology of panel cointegration and causality" because of the belief that there was significant heterogeneity in cross country economic growth so as to allow them estimate the presence of heterogeneity in the parameters and dynamics across countries. Their findings suggested that FDI had a significant positive relationship with economic growth in the case where all countries were included in the sample. On the other hand, when sample were split into high income countries and countries with successful privatization and those without successful privatization programs, and the findings were the same.

An empirical investigation carried out by Har (2008) which aimed to study the relationship between FDI and economic growth in Malaysia for the period 1970-2005 using time series data. Ordinary Least Squares (OLS) regressions and the empirical analysis were conducted by using annual data on FDI and economic growth in Malaysia over the period 1970-2005. This research used data from IMF international financial statistics tables, published by International Monitory Fund (IMF). Results showed that there was significant relationship between economic growth and FDI in the case Malaysia. FDI had direct positive impact on Real GDP, which FDI rate increase by 1% led to the growth rate increase by 0.046072%. Furthermore, FDI also has direct positive impact on Real Gross National Income (GNI) because when FDI rate increased by 1%, this led to the growth increase by 0.044877%).

Burridge, Liu and Sinclair (2010), set out to examine the causal relationships between economic growth, FDI and trade: evidence from China, by using multivariate Granger causality tests in a co integration framework. Multivariate causality, applied to quarterly data from 1981: 1 to 1997: 4, conducted showed that two-way causal connections existed between economic growth, FDI and exports, with rather weaker evidence of feedback from imports to the other three. The results also showed that failure to account for interaction between FDI, growth and external trade could produce spurious results in the analysis of the relationship between these four variables, as may be evident in some previously reported studies.

Srinivasan, Kalaivani and Ibrahim (2011) set out to investigate the causal nexus between FDI and Economic growth in SAARC countries. The Vector Error Correction Model (VECM) was employed to examine the causal nexus between FDI and economic growth in South Asian Association of Regional Cooperation (SAARC) countries for the years 1970-2007. The Impulse Response Function (IRF) had been employed to investigate the time paths Log of FDI (LFDI) in response to one-unit shock to the Log of Gross Domestic Product (LGDP) and vice versa. The results established a long run relationship between FDI and GDP for the sample SAARC nations namely Bangladesh, India, Maldives, Nepal, Pakistan and Sri Lanka. The empirical results of the vector correction model exhibited a long run bidirectional causal link between GDP and FDI for selected SAARC nations except India. The test results showed that there was one-way long-run causal link from GDP to FDI for India.

2.4.2 Local Evidence

Kinuthia (2005) set out to investigate the casual relationships between economic growth, FDI on determinants of FDIs in Kenya, by taking a panel data of five years confirmed that th main reasons for firms investing in Kenya are access to the local and regional market, economic and political stability and favorable bilateral trade agreements: fiscal concessions offered by Export Processing Zones (EPZs) were mentioned by only 10% of the business sampled. The economic growth estimation showed strong complementary effects between FDI and human capital. Overall, on the economic growth regression did not constitute prima facie evidence against the null hypothesis that FDI inflows did not promote economic growth in Kenya. However, the results suggest that FDI had a positive impact on the economic growth through the interaction of human capital.

Kiragu (2009) empirically analyzed the determinants of FDIs in Kenya base on the generalized least square method (GSL) revealed that economic openness is the most significant determinant of FDI inflows in Kenya. Other variables that were significant determinant of FDI inflows included growth rate of GDP, credit availability, exchange rate and internal rate of return. The rest of the remaining variables including tax incentives, inflation rate were statistically insignificant.

Mwega and Ngugi (2010) conducted a study that explored the possible effect of Foreign Direct Investment (FDI) on the economic growth performance in Kenya. The study employed secondary data for regression analysis. The sample consisted of annual data covering the period between 1975 and 2008. The growth rate of real gross domestic product per capita was used as a proxy for economic growth. Growth rate of labor, human capital, the ratio of domestic investments to GDP and the ratio of

FDI inflows to GDP were independent variables that explained the economic growth in Kenya. The results showed that through the human capital channel FDI was beneficial for growth.

A study done by Nyamwange (2012), to identify the key factors that influenced FDI decisions in Kenya and to explore the empirical relationship between FDI and economic growth in Kenya. The model employed in this study is the use of Ordinary Least Squares (OLS) model, which will use independent variables that are germane to economic growth. He found that the main determinants of FDI in Kenya were market size (proxied by GDP), stable macroeconomic policies and level of human capital that was tolerable by investors. The not significant relationship of human capital to overall economic growth suggested that there was a shortage of skilled labor in Kenya.

A study carried out by Ngugi and Ngonyo (2014) to empirically analyze the relationship between FDI volatility and economic growth in Kenya and how FDI volatility affects economic growth in Kenya. The period under study was 1970-2010; the data for the study were collected from National Bureau of Statistics, United Nations Conference on Trade and Development(UNCTAD) and International Financial Services (IFS) sources. The study modeled FDI volatility using EGARCH methodology, Autoregressive Distributed Lag (ARDL) bound was used to test for co integration and finally estimated vector error correction model to check the effects of FDI volatility on economic growth. The findings of the study were that there exists some level of FDI volatility in Kenya, where first lag conditional variance of FDI had effects on the current period conditional variance of FDI. The study found that FDI

volatility had long-run relationship with economic growth in Kenya and FDI volatility deterred economic growth in the long-run.

2.5 Summary of Literature Review

Several studies have been conducted on the empirical relationship between FDI and economic growth. Some of the studies have shown that FDIs positively influence economic growth in the host countries. However, the empirical evidence on FDI and its impact on the host country's growth are ambiguous at both micro and macro level. The positive effects on the growth of the host economy can come from investible financial resources filling the gap between investment and domestically mobilized savings. Many studies also exist concerning FDI and its determinants, yet there is no one conclusive argument on factors determining FDI and its subsequent effect on economic growth. Causality between FDI and economic growth is still unclear. If the determinants have strong links with growth in the host economy, growth may be found to cause FDI and output may grow faster when FDI takes place in other circumstances like the case of oil discovery. Other studies have noted that the economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investments produce externalities in the form of technology transfers and spillovers. Curiously, the empirical evidence of these benefits both at the firm level and the national level remain ambiguous, hence there is need for more consideration of the different circumstances that promote or obstruct spillovers.

Moreover, the above studies establish that large body of literature only examine the determinants of FDI begins with a partial equilibrium firm-level framework based in industrial organization and finance to motivate empirical analysis. These studies then typically examine how exogenous macroeconomic factors affect the firm's FDI decision, with the primary focus on the exchange rate movements, taxes, and to a more limited extent, tariffs. Earlier studies often then use industry-level (or even country-level) data to explore these hypotheses, while more recent work has had firm-and plant-level data available to more appropriately match the firm-level theory.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the overall methodology to be used in the study for gathering and analyzing data in order to achieve the research objective. This includes the research design, target population of the study, data collection methods and data analysis and finally we look at the analytical model that will be used.

3.2 Research Design

Research design is the arrangement of conditions for collection and analysis of data in a way that combines their relationship with the purpose of research (Mugenda & Mugenda, 1999). The study used descriptive design. Descriptive research design is used to describe characteristics of population or phenomenon being studied. It does not answer questions about how/when/why the characteristics occurred. Descriptive research design was the most appropriate method for collecting information that would demonstrate relationships and describe the world as it exists. These types of studies are often done before an experiment to know what specific things to manipulate and include in an experiment.

3.3 Data Collection

Data refers to factual information used as a basis for reasoning, discussion or calculation (Cooper, 2008). Secondary data of FDI was collected from central bank of Kenya Databases, the world periodical and economic survey reports and websites, the Treasury periodical financial reports and periodicals, National Bureau of Statistics-

the periodical economic survey and outlook reports and IMF periodical and economic survey reports and websites while economic growth data was also captured from the Central Bank of Kenya quarterly for the last 10 years, 2006- 2015.

3.4 Data Analysis

Straits and Singleton (1993) defined data analysis as systematically looking for patterns in the data collected and formulating ideas that account for those patterns. For quantitative data, the researchers used Microsoft Excel to carry out the data analysis. It incorporated all the most important analytical procedures for use in financial investment, social sciences and business research. To determine the relationship, simple linear regression was used.

3.4.1 Analytical Model

A multiple linear regression dimension of the independent and dependent variables was estimated using the linear regression model below to determine the relationship between FDI and economic growth. The analysis was quantitative and descriptive in nature. The model used was of the form;

$Y = \beta_0 + \beta i X_1 + \beta_2 X_2 + \beta_3 X3 + e$ Where;

Y= Economic growth measured by GDP growth rate Bo= the value of Y when X is zero

B = the regression coefficient of change induced on economic growth by FDI Xi = Foreign Direct Investment Measured by inflows and outflows

X_2 = Annual Inflation Rate

X3 = Exchange Rate measured by value of Kenya's currency against the dollar, s = error term

3.4.2 Test of Significance

Fishers test of significance was used as a measure of the overall significance of the regression model i.e. whether the resulting regression model was reliable to predict the values of economic growth. When the computed F-Statistic lies above the value 4.08 (F-stat in the tables at 98% confidence level), then the regression model is statistically significant-+. Alternately, at 2% significance level, when significance F is less than 0.02, then the deriving model is statistically significant.

t-Stat and p-value both show the significance of individual model parameters. The t-Stat is an absolute value, thus its positive or negative nature is disregarded. The higher the t Stat the more significant the parameter of interest while the lower the P-value the more significant the parameter of interest.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This chapter interprets the findings of FDI and economic growth of Kenya on the data collected for the years 1981 to 2010. Section 4.2 shows the descriptive statistics, Section 4.3 shows the correlation analysis, Section 4.4 concentrates on the regression analysis between FDI and economic growth, and then finally Section 4.5 examines the summary of the findings.

4.2 Descriptive Statistics

Table 4.1: Descriptive Statistics

		FDI	FOREIGN DEBT	ECONOMIC GROWTH	INFLATION RATE
N	Valid	30	30	30	30
	Missing	0	0	0	0
Mean		7.283685E7	6.045161E8	.033733	.1028
Mode		2.1212E7	3.5723E8	.0050a	.01[a]
Std. Deviation		1.3178544E8	1.4716896E8	.0221140	.07903
Variance		1.737E16	2.166E16	.000	.006
Skewness		4.542	.223	.017	2.516
Std. Error of Skewness		.427	.427	.427	.427

a. Multiple modes exist. The smallest value is shown Source: Researchers

From the descriptive statistics, it is inferred that all the variables are positively skewed. The mean FDI for Kenya for the three years is US$ 728,368,500, mean foreign debt is US$604,516,100, mean economic growth is 3.3% and the mean inflation rate 10.28%.

4.3 Correlation Analysis

Table 4.2: Correlation Analysis

		FDI	FOREIGN DEBT	ECONOMIC GROWTH	INFLATION RATE
FDI	Pearson Correlation	1	-.242	.269	-.028
	Sig. (2-tailed)		.197	151	.884
	N	20	30	30	30
FOREIGN DEBT	Pearson Correlation	-.242	1	-.046	.420
	Sig. (2-tailed)	.197		.809	.021
	N	30	30	30	30
ECONOMIC GROWTH	Pearson Correlation	.269	-.046	1	-.261
	Sig. (2-tailed)	.151	.809		.164
	N	30	30	30	30
INFLATION RATE	Pearson Correlation	-.028	.420	-.261	1
	Sig. (2-tailed)	.884	.021	.164	
	N	30	30	30	30

*• Correlation is significant at the 0.05 level (2-tailed).

Source: Researchers

From the correlation table above, there is a weak negative relationship between FDI and Foreign debt (r=-0.242, t=0.197), a weak negative relationship between inflation rate and FDI (r-0.028, t=0.884), a weak negative relationship between foreign debt and economic growth (r-0.046, t=0.809) and a weak negative relationship between economic growth and inflation rate (r-0.26 1, t=0.809). The correlation table indicates a weak positive relationship between FDI and economic growth (r=0.269, t=0. 151), a weak positive relationship between Foreign debt and inflation rate (r0.420, t0.021).

4.4 Regression Analysis

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.146[a]	.021	-.091	.905211

a. Predictors: (Constant), LN INFLATION RATE, LN FDI, LN FOREIGN DEBT

Source: Researchers

Table 4.3 shows that the regression coefficients of independent variables categorizing the linear relationship between the dependent and independent variables. Looking at model summary, a correlation coefficient of 0.146 was obtained depicting a low correlation between foreign direct investment and economic growth. The model indicates that 2.1% variations in economic growth is explained by variations in FDI, foreign debt and inflation rates (R squared = 0.02 1).

Table 4.4: Analysis of Variance (ANOVA)

Model		Sum of squares	Df	Mean Square	F	Sig.
1	Regression	.467	3	.156	.190	.902[a]
	Residual	21.305	26	.819		
	Total	21.771	29			

a. Predictors: (Constant), LN INFLATION RATE, LN FDI, LN FOREIGN DEBT

b. Dependent Variable: LN GDP GROWTH

Source: Researchers

Analysis of Variance (ANOVA) was used to show the significance of the regression model.

The ANOVA results presented in Table 4.4 shows that the regression model has a margin of error of p = .902. This indicates that the model was insignificant.

Table 4.5: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	2.902	15.912		.182	.857
	LN FDI	-.036	.128	-.056	-.278	.784
	LN FOREIGN DEBT	-.051	.759	-.015	-.067	.947
	LN INFLATION RATE	-.144	.239	-.128	-.603	.552

a. Dependent Variable: LN GDP GROWTH

Source: Researchers

The following regression model was established:

Economic Growth = 2.902 - 0.036*FDI - 0.051*Foreign Debt - 0.144*Inflation Rate

From the model, FDI (13=-0.036, t=-0.278, p=O.784), Foreign debt (13=-0.051, t-0.067, p0.947) and inflation rates (β=-0.144, t=-0.603, t=0.552) negatively relates with economic growth in Kenya. However, the regression coefficients were insignificant as shown by t-significance values above 0.05.

4.5 Interpretation of Findings

This explores the impact of foreign direct investment on the Kenyan economy using FDI and GDP inflow data series from 1981-2010. Descriptive statistics are tabulated to give a brief summary of the variables under consideration. On the basis of our findings, empirical results conclude a positive relationship between FDI and GDP. Various inferential analyses were used to establish relationship between variables.

Regression analysis shows that the variable had a correlation coefficient of 0.146. This shows a low level of relationship between foreign direct investments and economic growth in Kenya.

Economic growth is brought about by other factors such as increased government expenditure and increased in the level of exports. FDI contributes has a little impact on the economic growth as the technology, capital and human skills brought in Kenya do not influence the economy to a great extent due to other economic factors in the country.

The Analysis of Variance (ANOVA) used to show the significance of the regression model used. The model resulted to a margin of error of p= .902 thus was insignificant. Thus the model was not ideal to make a certain relationship population's parameters as the value of insignificance. This is an indicator that foreign direct investments, was not in contribution to the growth of the economy.

The regression coefficient established the equation:

Economic Growth= 2.902 - 0.036FDI —0.051Foreign Debt — 0.144 Inflation Rate

This is to depict that FDI has a negative impact on the economy. There are effects brought by FDI such as crowding in and crowding out effects, negative wage spill overs, profit repatriations and balance of payment effects. These effects restrain the economy channels its resources to counter them instead of spurring the economy. However the regression coefficients were insignificant due to the t-significance value above 0.05 which shows that the model is not to be depended on.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings of the study in Section 5.2, and Section 5.3 concludes our final results of the study. Section 5.4 summarizes the recommendations and finally Section 5.5 shows the suggestions for further studies.

5.2 Summary

The study sought to explain the measurements of both FDI and economic growth, the impact of FDI both negative and positive, policies used to improve FDI to increase economic growth. It elaborates the research problem, its objective and its value to other researchers and the economy as a whole. The study presented the theories regarding FDI and economic growth. The theoretical studies on FDI and economic growth led to a better understanding of the economic mechanism and the behavior of economic agents, both micro and macro level.

The study by conducted by Mwega and Ngugi (2007) on the effects of FDT on the economic growth performance in Kenya showed that through human capital channel FDI may be beneficial for growth and that it had a positive effect on economic growth. This study corresponded well with the study done by Har (2008) aimed to study the relationship between FDI and economic growth in Malaysia for the period 1970-2005, results showed a positive impact of FDI to real GDP. Nonetheless Carkovick and Levine (2002) argue that there is no significant positive relation between FDI and economic growth. Even when the relation is positive, the effects tend to be weak. Based on the research questions, the methodology uses a quantitative

research design that helps to identify the numerical characteristics of the effects of FDI on economic growth in Kenya. The study collected data on FDI.

The findings show that there is a weak and insignificant relationship between FDI and economic growth, this implies that an increase or a decrease in FDI does not really bring about an increase or a decrease in economic growth, this is because other variables like inflation rate and foreign debt have also played a big role in contribution to changes in economic growth. The two variables have a negative relationship to economic growth as seen in the mode. Based on this, the need to increase FDI does not really matter as the inflation rate and the amount of foreign debt has to be reduced so as to increase economic growth.

5.3 Conclusion

Results from the regression analysis estimates show that FDI has a negative and inverse effect on the level of economic growth in Kenya. The contribution of Foreign Direct Investment is however observed to be relatively less as compared to other types of investments. Moreover it is also on the lower side as compared to previous studies on non African economies and this might be explained by the fact that African countries have been among the lowest beneficiaries of FDI.

Concerning the question on the causality of FDI and GDP, the findings do not provide conclusive evidence of the existence of a virtues circle, hence the causality is concluded to be more of a one-way, while the vice versa effect is low. The findings, however do not point to an existence of a connection between FDI and Economic

growth which is strengthened when other factors are included in the analysis; a very significant matter of the economy of the developing nations.

5.4 Policy Recommendations

Going by the findings drawn from this study, the following recommendations are suggested. Monetary policy to maintain a low inflation rate, first the Central Bank of Kenya (CEK) to try and predict future inflation. They look at various economic statistics and try to decide whether the economy is overheating. If inflation is forecast to increase above the target, the CBK will increase interest rates. This will help reduce the growth of Aggregate Demand in the economy. The slower growth will then lead to lower inflation. Higher interest rates reduce consumer spending because increased interest rates increase:-the cost of borrowing, discouraging consumers from borrowing and spending, -make it more attractive to save money,-reduce the disposable income of those with mortgages, -increase the value of the exchange rate leading to lower exports and more imports.

The government also needs to go a step further and actively seek to attract FDI by marketing our economy and eventually set up national investment promotion agencies (IJNCTAD, 2001). In a nutshell, regarding investment promotion policies, Kenya should adopt a proactive approach towards FDI promotion, and explicitly look for ways to increase its benefits in terms of technology, skills and market access. Under these types of policies, foreign investors are targeted at the industry/firm level in order to meet Kenya's specific needs that fit in with its developmental priorities. An increase in FDI in Kenya will automatically lead to a decline in foreign debt which is

the recommendation for the government in order to stop suffering from any foreign debts.

5.5 Limitations of the Study

Limitations are the boundaries that restrict the research scope and may cause difficulty in completing the research (Cooper & Schindler, 2002). Obtaining data for the study was problematic in the sense that the Central Bank of Kenya (CBK) Statistical Bulletin and Financial review for the various years was only available for a few of the years under study. The central bank website also seems to experience perennial problems that make it inaccessible most of the time. Nonetheless, the data available at the Kenya National Bureau of Statistics is not in soft form so a lot of time was utilized going through heaps of publications.

The research study was conducted for a sample of 30 years and as such may not be an exact representative of the situation on the ground since a lot has been happening in Kenya during the duration under consideration such as the Structural Adjustments Programms (SAPs) of the 1 980s, adoption of multiparty politics in the early 1 990s, the post election violence of 2007/2008 as well as the global financial crisis of 2009. The findings of this study may also be subject to the researchers' bias. For instance, the results of the research might be subject to design and sampling bias whereby the process of sampling introduces an inherent bias into the study.

5.6 Suggestions for Further Studies

The present Kenyan constitution having been promulgated during the last three years introduced a devolved system of government. With this in mind, further studies should focus on analyzing sector and county specific cases so as to allow for specific policy recommendations and employ more robust econometric models. As such the impact of FDI on the economy might be made more successful. The backbone of the Kenyan economy is Agriculture; although there is presently a huge of quantity of FDI funds channeled towards farming, much of it is through foreign affiliates who have established subsidiaries here. An example is Del Monte based in Thika. In this regard, studies should be conducted into the feasibility of channeling FDI towards the small scale agricultural industry and with an aim to counter poverty.

In the wake of the recently vibrant mining sector wherein foreign affiliates with their superior knowhow and equipment being bound to lead exploration of natural resources in Turkana, studies should be conducted prior to breaking ground so that appropriate policies are put in place to hinder negative impacts on the local economy. This study employs macroeconomic variables in investigating the impact of FDI on economic growth in Kenya. A study should be conducted on investor responses about the impact of various institutional variables to their businesses in that it would provide information on the other side of the coin; FDI viewed from the MNCs perspective.

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APPENDIX I: ANNUAL INFLATION RATE, EXCHANGE RATE FOREIGN DIRECT INVESTMENT AND GROSS DOMESTIC PRODUCT

YEAR	INF	GDP	EXR	FDI
1986	2.53	7.18	127.48	39.38
1987	8.64	5.94	120.51	0.39
1988	12.26	6.2	113.32	62.19
1989	13.79	4.69	112.49	57.1
1990	17.78	4.19	116.69	18.8
1991	20.08	1.44	112.82	6
1992	27.33	-0.7995	109.59	2
1993	45.98	0.35	147.41	4.3
1994	28.81	2.63	117.05	33
1995	1.55	4.41	110.48	10.55
1996	8.86	4.15	111.38	53
1997	11.36	0.47	104.28	11
1998	6.72	3.29	106.25	13.82
1999	5.74	2.31	117.29	110.9
2000	9.98	0.6	121.05	5.3
2001	5.74	3.78	117.6	27.62
2002	1.96	0.55	117.62	81.74
2003	9.82	2.93	112.44	46.06
2004	11.62	5.1	111.79	21.21
2005	10.31	5.91	100.25	50.67
2006	14.45	6.32	92.18	729.05
2007	9.76	7.01	88.14	95.58
2008	26.24	1.55	82.04	140.52
2009	9.23	2.59	82.62	17.81
2010	3.961	5.754	86.53	19.12
2011	8.36	5.8	95.38	11.45
2012	7.67	4.4	105.26	14.82
2013	31.5	4.6	98.51	16.93
2014	30.2	5.1	105.1	17.94
2015	31.4	6.2	103.25	18.25

SOURCE: Kenya National Bureau of Statistics (KNBS) (2015). Kenya's Economic Growth Indicators, 2015. Kenya National Bureau of Statistics 2015 Report.