

Foreign Direct Investment (FDI) into Tanzania Manufacturing Sector for Promotion of Employment. A Demystification

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Abstract: *Lately the African Sub-Saharan nations have witnessed massive inflows of FDI, Tanzania inclusive. This calls for the need to evaluate the effect of the FDI to economy of the recipient nations. A range of theoretical and empirical literatures suggest various links through which FDI exert positive impact on economy of the recipient country, including the positive effect that FDI have on the growth and employment creation. This paper used secondary data and time series data from 1990 to 2012 and argues that there exist a positive relationship between FDI Inflows and Economic growth. This means that the FDI inflows in the industrial sector have a direct positive impact on economic growth in Tanzania. The study also confirms that there exists a positive relationship between FDI Inflows in the manufacturing sector and employment creation.*

Keywords: Economic growth, Employment creation, manufacturing sector, FDI, Tanzania

Introduction

Theory and empirical evidences have shown that Foreign Direct Investment (FDI) currently occupy an important position in the development agenda of most developing nations. This is because they can contribute to a vibrant and growing industrial sector provided they operate in an appropriate institutional environment (Alfaro 2014; UNCTAD 2014 and Ousseini *et al.* 2015). FDI is by and large considered as a growth-enhancing factor in recipient nations as it does not only attract capital, but also bring in modern and superior technology that can enhance the technological competence of firms in the recipient nation (UNCTAD, 2010). Additionally, (World Bank, 2012) spell out that FDI from investors in developed world such as Japan, the European Union and the United States of America supply financial capital and skills to assist smaller firms in the developing nations to enlarge and augment international sales.

The employment effects of FDI are of considerable interest to host developing countries. In many of them, a key requirement for sustainable growth is the ability to absorb the human resource released from agriculture into manufacturing and service industries. The quantitative effects of FDI on employment globally have been found to be modest, but somewhat larger in host developing than host developed countries, and especially so in the manufacturing sector (World Investment Report, 1999).

Also (Alvarez and Holger 2007; Adams 2009) argue that the importance of FDI has emerged from the role played by multi-national companies (MNCs) in creating positive externalities in economic growth by means of providing financial resources, generating

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employment, transferring technological know-how, managerial and organisational skills, and enhancing competitiveness.

Literature indicates that there is a direct relationship between FDI especially in the manufacturing sector and its impact on economic growth and employment creation. The traditional argument by scholars like Zhangh (2014), Denisia (2010), and Adams (2010) all agree that an inflow of FDI improves economic growth and thereby enhances employment opportunities. This indicates that the future and success of Tanzania depends on the number of persons in employment and how productive they are at work. In response to the problem of unemployment the government of Tanzania and policy makers placed employment creation at the centre of their national economic and social recovery policies since 2005 (Mpanju, 2012).

Objective of the Study

The objective of this paper is to analyze the impact of FDI on economic growth and employment creation in Tanzania singling out the manufacturing sector and particularly its implications to the ongoing efforts to poverty reduction.

Specific objectives,

1. To examine the relationship between FDI and employment creation in Tanzania.
2. To analyze the contribution of FDI in economic growth.

Hypothesis

H1: FDI relates positively with employment creation in Tanzania

H0: FDI does not relate positively with employment creation in Tanzania

H2: FDI contributes to economic growth in Tanzania.

H0: FDI does not contribute to economic growth in Tanzania

Review of Literature

The role of FDI has been widely recognized as growth-enhancing factor in the developing countries. Several studies show that FDI contributes positively to economic growth and employment creation in the host economies. This is applicable when FDI provides financial resources for the intended investment with a view to expanding a country's potential to enter into export markets resulting from FDI productivity gains. Ayanwale (2007) and Selma (2013) both identify such productivity gains to emerge from technology transfer, introduction of new processes, managerial skills, and knowledge of access to both international and domestic markets. Earlier studies by Borensztein et al. (1998) made a case for the increase in the rate of technical progress in the host country as a result of FDI. Jenkins and Thomas (2002) and Volos and Kyprianidis (2015) on the other hand made a case for employment creation, human capital development and contribution to international investments as some of the positive effects of FDI. In the same view, the level of FDI in Tanzania and economic growth has been on a steady rise since the early 1990s.

FDI and its influence on a nation's competitiveness is a key objective for Tanzania as a country. It is considered as one of the main pillars of the transformation of the country to middle economy (semi industrialized). The country's vision's document (URT, 2014) spells out the country's intention to be transformed from a low productivity agricultural economy to a semi-industrialized one led by modernized and highly productive agricultural activities which are effectively integrated and buttressed by supportive industrial and service activities in the rural and urban areas (Azizi *et al.* , 2015).

In Tanzania the increase in FDI has been recognized and singled out as one of the most important factors for poverty reduction as currently prioritized in the national policy to attract direct foreign investment into modern and industrial scale agriculture. This is set out in the Southern Growth Corridor of Tanzania (SAGCOT, 2014), the Big Results Now (BRN, 2013) initiatives and National Strategy for Growth and Poverty Reduction (NSGRP, 2005). Tanzania has set targets for itself. An industrialized middle income country by 2025, having made meaningful progress towards the Sustainable Development Goals as a response to the country's development challenges including unemployment, economic growth and remain competitive. Tanzania has opened its economy and hopes to grow its economy and develop as a result of FDI business interaction with the private sector and outside world. The manufacturing sector is a key contributor to both employment and revenue to the country (URT 2011; BOT 2012; Leipold & Morgante 2013).

Economic Reforms as an ingredient for attracting FDI

Tanzania government has taken significant measures to liberalize its economy along market lines and promote both domestic private investment and foreign multinationals. This ensued in the period 1986, when the Government embarked on structural adjustments which led to the abolishment of socialist (Ujamaa) economic controls and supported active participation of the private investors in the economy. It is important to mention that globalization has integrated the world economy into a single market and production platform (World Bank, 2012), in which firms, countries and regional economic blocks compete to maximize their share of the global market and their foreign policies to ensure ease of flow of resources into their economies.

Structural reforms in Tanzania were expected to induce a strong entrepreneurial response – which would materialize in new investments, technological modernization and productivity increases- and improvements in welfare and resource allocation efficiency due to trade liberalization and increase employment opportunities. (Wagner, 2011), argues that the emphasis of the structural adjustment and poverty reduction among others things is on enhanced private sector role in development that includes small and large firms and a market-led economy, with the aim of increasing productivity generally and strengthening the industrialisation process in particular. Productivity – the efficiency with which firms turn inputs (labour, physical capital, energy, materials, managerial know-how) into outputs (goods, services) – is important for the competitiveness of firms, regions and countries on local, national and international markets.

Inflows of FDI in Tanzania

In 2014 the top five recipients of FDI in Least Developed Countries were Mozambique which attracted US\$ 4.9 billion down by 21%. Zambia received an estimated US\$ 2.5 billion going up 37% while the United Republic of Tanzania received US\$ 2.1 billion which was a 1% increment. Likewise, Equatorial Guinea obtained FDI amounting to US\$ 1.9 billion which was 1% increase. On the other hand, Democratic Republic of the Congo realized 2% decrease in FDI inflow equivalent to US\$ 2.1 billion. These five countries accounted for 58% of total FDI inflows to LDCs in the period 2014. By and large the industrial sector of Tanzania has benefited and still benefits from FDI. This implies that FDI is perceived as a major contributor to the growth and development of the industrial sector.

The opening of Tanzania economy to FDI in mid 1980s led to a rapid increase in FDI inflows from nothing in 1990 to US\$ 653 million in 2011, resulting to an increase of FDI stock in the country to US\$ 6.5 billion as shown in Table 1. Tanzania compared to other regional

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countries in sub-Saharan Africa (including Zambia, Senegal, Botswana and Lesotho) in terms of FDI inflows, Tanzania did relatively well with the stock of US\$ 2351 in 2002. In terms of the inflows of FDI in 2002, Tanzania performed relatively well slightly lower than Uganda but relatively higher than Zambia, Senegal, Botswana and Lesotho, this is according to Tanzania Investment report (2004).

Table 1: FDI inflows and FDI stocks to Tanzania (1990 – 2008) US\$

Year	FDI Inflows	FDI Stock
1990	0	388,000,000
1991	0	388,000,000
1992	12,000,000	400,000,000
1993	20,000,000	420,000,000
1994	50,000,000	470,000,000
1995	150,000,000	620,000,000
1996	149,000,000	681,000,000
1997	158,000,000	760,000,000
1998	172,000,000	1,715,000,000
1999	497,000,000	1,989,000,000
2000	282,000,000	2,778,000,000
2001	467,000,000	2,960,000,000
2002	388,000,000	3,243,000,000
2003	308,000,000	4,139,000,000
2004	331,000,000	4,759,000,000
2005	494,000,000	4,390,000,000
2006	597,000,000	5,342,000,000
2007	647,000,000	5,942,000,000
2008	679,000,000	6,621,000,000
2009	637,000,000	5,942,000,000
2010	538,000,000	4,970,000,000
2011	653,000,000	6,551,000,000
Total	7,229,000,000	65,468,000,000

Source: TIC, UNCTAD, IMF (2012)

FDI in Manufacturing and Employment Creation in Tanzania

The manufacturing sector seems to be the best possibility for modern employment expansion in the Tanzania's labour market. In general, the industrial sector remains the most reliable source of government revenue in terms of import sales, corporate and income taxes. It accounts for over half of government annual revenue collection. Moreover, it is the industrial sector that provides reliable field to practice invention, innovation and nurturing modern technologies for production and service provision, (Semboja, 2010)³.

³ Semboja Haji Hatibu Haji, (2010), the study on Emerging Enterprises in Manufacturing Sector: Data and Policy Analysis. Reported submitted to MIT and JICA.

Table 2: GDP, FDI and Job Creation in Tanzania, 1990 – 2012

Year	FDI inflows – US\$	Employment generated	GDP (US\$)
Up to 2006	2,653,000,000	497,537	113,615,000,000
2007	331,000,000	54,091	13,142,000,000
2009	494,000,000	55,694	14,492,000,000
2010	597,000,000	76,653	14,739,000,000
2011	647,000,000	103,958	17,299,000,000
2012	679,000,000	125,231	21,328,000,000

According to the Integrated Labour Force Surveys (ILFS) of 2000-01 and 2005-06 report URT (2007), there was an increase of 2.8 million people in the Tanzanian labour force. This is equivalent to a 16.0 percent increase between 2000-01 and 2005-06. The analysis result of ILFS 2005-06 showed that of the total 18.3 million people who were employed, 9.0 million were males while 9.3 million were females. The share of agriculture was 77.0 percent in 2006 down from over 83 percent in 2000- 01. This reflects a decline of employment in agriculture activities by more than 6 percent in six years. However, the rate of increase of manufacturing employment in Tanzania has been low and stagnant for many of industrial activities during the last five years. Likewise ILO (2010) affirm that the rates of unemployment and under employment are quite high, particularly for the youth regardless of whether they are educated or not, who also lack the voice in the decision making bodies.

The United Republic of Tanzania report (2007), revealed that the total labour force for youth has increased by 2.8 million people from 17.8 million in 2000/01 to 19.8 million in 2006. This implies that 560,000 new people have been entering in the labour market every year. This is an increase of 16.0 percentage point. Also, the survey report indicates that the unemployment rate has decreased as GDP has increased from 5.7 percent in 2000/01 to 6.8 percent in 2006. Furthermore, According to Patricia (2013) and URT (2007) report shows that households have been diversifying their economic activities and employment to population ratio increased from 67.0 percent in 2000/01 to 71.0 percent in 2006.

Factors Determining the FDI – Employment Relationship

The main factors we can cite here are FDI motivation, their market strategies, the entry mode and host sectors' characteristics. This last factor is of major importance for the role that FDI can play in employment, and furthermore in enhancing economic growth. The industry in which FDI is located plays a crucial role in the potential impact on employment. If location is in industries that are capital and technology intensive, with high value added, it is expected that the effect on the employment level to be insignificant. If FDI replaces local firms that were using relatively labour intensive techniques, the effect can be even negative (Dunning, 2008). If FDI is located in labour intensive sectors, the quantitative effect on employment can be positive and significant. An example is the service sector, which showed a high increase in the share of world FDI and which presents a high potential for labour employment, especially skilled labour. This is the case for banking services, insurance, real estate etc., which characterizes market-seeking FDI. The most important increase is though registered for business services. They are off shored by firms from developed countries in fields like IT services, accounting, financial analysis, call centres. A major driving force for off shoring these activities was the speed of communications and internet access.

Another essential factor which conditions the skill structure of employees is the nature of FDI activities and the technology transfer that accompanies FDI. Depending on these factors, the

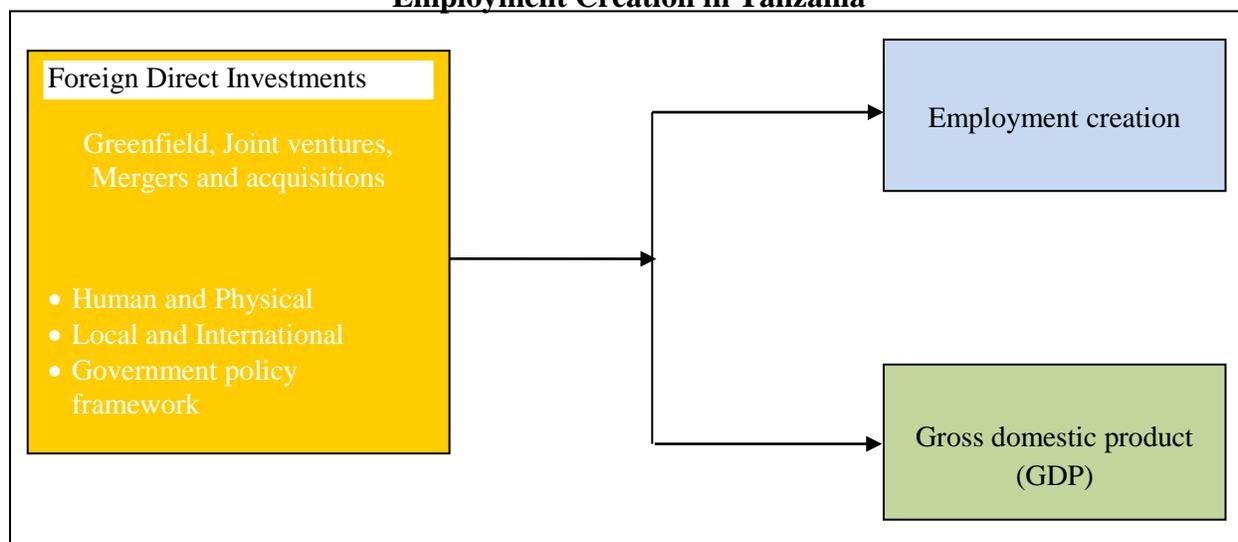
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consequence can be an increase or decrease of the average skill level of employment. Thus: When FDI uses a modern technology, this means a demand for skilled workers (already having the skills or acquiring them by training). It can also require support functions or research & development, therefore increasing employment for the highly skilled (Feenstra and Hanson, 1997). If FDI runs low technical level activities (i.e. assembling operations), the increase in employment can still be registered for the low skilled workers. But as a consequence, the medium skill level will decrease and some workers might even lose some of their skills (Johannes, 2006)⁴.

Conceptual Framework

The conceptual framework is composed of three variables namely, FID which is considered as independent variable and employment creation and GDP both considered as dependent variables.

Figure 1: Conceptual Framework Showing the Relationship between FDI and its Impact on Employment Creation in Tanzania



Methodology

The study used data from 1980 to 2012 and employed a generalized economic analytical approach to illustrate the distinctive outputs GDP_i and EMP_i where GDP_i is the output from FDI interventions on GDP while EMP_i illustrates impact of FDI on employment yields.

The study used unrelated regressions to estimate employment equation (1) and GDP equation (2), taking into consideration the fact that FDI terms in a single equations may be somehow correlated. In carrying out the regression, the study imposed cross-equation restrictions on regression parameters to ensure that the same estimate is produced for any factor that is shown in more than one equation. The analysis also covered co-integration that tests the relationship among the variables; ordinary least square method (OLS) and error correction model.

The research hypothesized that economic growth (GDP) and employment creation (EMP) are influenced by several factors and the measure of the effects can be established using the

⁴ Johannes, Stephan (2006), Technology Transfer via Foreign Direct Investment in Central and Eastern Europe Theory, Studies in Economic Transition, Palgrave Macmillan

{ $EMP_i = \beta_0 + \beta_1 FDI_i + \epsilon_i$ } and { $GDP_i = \beta_0 + \beta_1 FDI_i + \epsilon_i$ } models which produced remarkable results in a study by carried out by Mpanju (2012) when assessing the impact of Foreign Direct Investment on employment creation in Tanzania from 1990 to 2008. In the model FDI_i is used as independent variable whereas EMP_i (employment creation) and GDP_i (economic growth) as dependent variable on each year of the FDI inflows expressed as shown in equation

(1) and equation (2) respectively.

Employment is modelled as a function of mainly the FDI, GDP, capital formation, openness of economy which translated into equation 1.

$$EMP_i = \beta_0 + \beta_1 FDI_i + \epsilon_i \dots\dots\dots (eq. 1)$$

The GDP is taken as a function of FDI, Labour, capital formation which is modelled simply as equation 2.

$$GDP_i = \beta_0 + \beta_1 FDI_i + \epsilon_i \dots\dots\dots (eq. 2)$$

Whereas FDI_i = function of GDP, open economy, interest, labour, inflation and tax.

In the model all the variable indicated are drawn from the conceptual framework, apart from i which controls the trends in time. The variables are explained as follows:-

FDI_i = Foreign direct investment at particular time i

EMP_i = Employment created at particular time i

GDP_i = Gross domestic product at particular time i

β_i = Represent coefficient of regression

β_0 = Represent slope of regression

ϵ_i = Represent the error term

The idea behind the measurement of these variables is as follows. Since current data on the stock are not available the paper used the investment figure as a proxy for the stock, employment and GDP.

Testing of Hypothesis One

This hypothesis sought to establish the relationship between FDI inflows and its impact on employment creation in the industrial sector of Tanzania. It is important to mention that the hypothesis was stated null and alternative hypotheses as shown below.

H₁: FDI relates positively with employment creation in Tanzania

H₀: FDI do not relate positively with employment creation in Tanzania

In testing the relationship between FDI Inflows and employment creation of the industries, the Correlation Coefficient and Linear Regression tests were used. Tables 3 and 4 below summarise the Linear Regression and correlation coefficients for two variables, which involved “interval data”, see table 2.

Table 3: Hypothesis 1: Linear Regression Model Summary - FDI Vs EMP

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.861(a)	.742	.656	82,646,134.72189

a Predictors: (Constant), Employment

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The Correlation Coefficient ($r = 0.861$) obtained in Table 3 indicates that there is a strong association between two variables. It also shows the association between FDI and employment creation is highly positive. The coefficient of determination ($r^2 = 0.741$) measures the proportion of the total variation in the values. This means over 90 percent of variation FDI Inflows can be explained by variation on employment creation pattern within the industrial sector, leaving 10 percent of variation to be explained by other factors. The two tailed significance test shows that regression coefficients and constants are statistically significant at the 5 percent level. This means that there is sufficient evidence in study that FDI has significant impact on employment. In order to confirm the findings from the linear regression the study also tested the relationships using the Correlation Coefficient and the Bi-variate Correlation test. The results are presented in Table 4.

Table 4: Testing relationship between FDI Inflows and Employment creation

		FDI Inflows	Gross Domestic Product
FDI Inflows	Pearson Correlation	1	.861
	Sig. (2-tailed)	.	.061
	N	11	11
Gross Domestic Product	Pearson Correlation	.861	1
	Sig. (2-tailed)	.061	.
	N	11	11

From the results of the correlation analysis on table 4, the analysis used FDI inflows as independent variable which was perceived to have either positive or negative effect on the employment creation pattern within the manufacturing sector of Tanzania which the study treated as the dependent variable. The analysis used the Pearson Correlation which assumed that the data generated for the analysis were normally distributed thus measured linear association between two variables. The results in Table 4 depict a positive correlation as revealed by the sign (+ve). Since the correlation is positive it implies that there exists a positive relationship between FDI inflows and employment creation. Absolute value designates the strength of relationship which in this case was noted to be 0.861. In this case there relationship was considered as very strong.

Therefore the study concludes that FDI inflow in the industrial sector has a direct positive impact on employment creation. Hence the study accepted the null hypothesis (H1) and dropped the alternative hypothesis.

Testing of Hypothesis Two

This hypothesis sought to establish the relationship between foreign direct investments inflows and its impact on economic growth in Tanzania. The hypothesis also was stated null and alternative hypotheses as shown below.

H₂: FDI contributes to economic growth in Tanzania.

H₀: FDI do not contribute to economic growth in Tanzania

Again to test the relationship between FDI inflows and economic growth, the correlation coefficient and linear regression tests were used. Tables 5 and 6 below summarise the Linear Regression and correlation coefficients for two variables respectively, which involved interval data.

Table 5: Hypothesis 2: Linear Regression Model Summary - FDI Vs GDP

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.803(a)	.645	.527	96877470.03918

a Predictors: (Constant), GDP

The linear regression ($r = 0.803$) obtained in Table 4 indicates that there is a strong association linking the two variables. In addition it shows that the association between FDI and GDP is positive. The coefficient of determination ($r^2 = 0.645$) measures the percentage of the total variation in the values which means that over 90% of variation FDIs are determined by variation of the manufacturing sectors' contribution to the GDP of Tanzania. This leaves 10% of variation to be explained by other factors. Thus the model shows that FDIs has a positive impact on the performance of the manufacturing sector and economic growth of the country. The two tailed significance test shows that regression coefficients and constants are statistically significant at the 5% level. Based on the evidence generated from the Table 5 establishes that FDI has a strong impact on GDP.

A similar to the pattern of analysis used in testing the hypothesis one, the study also tested relationship between FDI and GDP involving the correlation coefficient using the Bi-variate Correlation method. The results are presented are shown in Table 6.

Table 6: Testing relationship between FDI Inflows and Economic growth

		FDI Inflows	Gross Domestic Product
FDI Inflows	Pearson Correlation	1	.803
	Sig. (2-tailed)	.	.102
	N	11	11
Gross Domestic Product	Pearson Correlation	.803	1
	Sig. (2-tailed)	.102	.
	N	11	11

It is evident from table 6 that the correlation analysis also used FDI inflows as independent variable which was perceived to influence the manufacturing sector of Tanzania to contribute to the growth of the economy of Tanzania either positively or negatively. In this regard economic growth was considered as the dependent variable. Using the pearson correlation, it was assumed that data was normally distributed in the period under analysis thus the analysis measured linear association between two variables. The findings of the analysis reveal that there exists positive correlation as shown by the correlation sign (+ve). By implication it is suffice to say that there exists a positive relationship between FDI inflows and economic growth in Tanzania. The correlation value $r = 0.803$ depicts that the relationship is very strong. Thus, FDI inflows in the industrial sector have a direct positive impact on economic growth in Tanzania. Therefore the study accepted the null hypothesis (H₂) and dropped the alternative hypothesis.

Conclusion and Recommendations

The study concludes that as a result of increased FDI inflows, the government of Tanzania concentrated its efforts to formulate policies and create conducive environment in order to attract more FDI inflows. There exist a positive relationship between FDI inflows and economic growth in Tanzania. Since the correlation is positive it implies that there exists a positive relationship

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between FDI inflows and employment creation. Absolute value designates the strength of relationship which in this case was noted to be 0.861. In this case there relationship was considered as very strong. The correlation value $r = 0.803$ depicts that the relationship is very strong. Thus, FDI inflows in the industrial sector have a direct positive impact on economic growth in Tanzania.

The study recommends that Tanzania needs to put additional effort in attracting FDI in the industrial sector. The sector already shows that FDI enhance competitiveness of the country's economy. Oketch (2011) made realistic recommendations in the area. One, there is a need to establish a system for continuous consultation between FDI investors and labour unions on issues related to labour laws. It is also prudent to market the industrial products abroad in order to widen the market and revenue. In fact, that is the trend that countries that have achieved significant employment boot from FDI such as Ireland, Singapore and Hong Kong did as was established by Moon et.al (1998) in their study on a generalized double diamond approach to the global competitiveness. Moreover, investors abroad may not even know the potential opportunities are available in the sector especially now that the country has discovered natural gas as an alternative source of energy among other high values resources.

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