

Causality between Economic Growth and Investment in Zimbabwe

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Abstract

The paper aimed at investigating the causal relationship between investment and economic growth in Zimbabwe using Granger causality methodology. Results revealed that causality does not run in any direction and hence the two are independent. These results are not the only one in literature since they are in line with others such as Verman and Wilson (2005) but are contrary to those of Samake (2008). It is recommended that Zimbabwe should invest in modern day technology to improve its growth.

Key words: Economic growth, investment, causality, Zimbabwe

1. Background to the Zimbabwean Growth and Investment

Since attaining independence from Britain, Zimbabwe's economy has been on a free fall especially in terms of economic growth. The first decade and a half were however better than what later followed. Gross Domestic Product (GDP) is seen to be generally on an upward trend from 1980 up to the 1992 drought which brought the economy to a whopping -9.02% economic decline, (www.worldbank.org/data). For the period under review, however, investment, as proxied by gross capital formation as a percentage of GDP was growing to average 16.9% with a standard deviation of 3.69. The most compelling thing then is, even if investment was growing, GDP fell for the last part of the period. This goes against conventional economics wisdom that investment is the engine for growth. Some economists generally believe that economic growth emanate from investment, through the so called multiplier effect, while others believe it is growth that lead investment, the so called accelerator theorem.

It is therefore, from the above argument, inconclusive as to which leads the other. The aim of this research paper is to give an analysis of this relationship to reveal the direction of causality that is, testing the applicability of the multiplier-accelerator theorem.

This paper is organized as follows: The next section reviews relevant literature followed by model specification. The fourth section presents the results and analyse them and the paper is wrapped up in the last section by recommendations especially to policy-makers.

2. Review of Relevant Literature

Literature has it that investment is the engine for economic growth. It is argued that the availability of investment funds enables people to invest since this availability will make the cost of borrowing relatively cheap. The argument is that the major source of funds is borrowing such that a reduction in interest rates that is lending rates will lead a surge in demand for loans for investment purposes. This is because projects that were previously marginal will now be profitable.

It was Samuelson (1939) in Westerhoff (2006) who introduced the concept of the multiplier-accelerator. The model as argued by Westerhoff (2006) may generate temporary business cycles. The argument of the multiplier-accelerator theory is that autonomous expenditure lead growth via the multiplier but growth in turn has a feedback effect on induced investment in the economy via the accelerator process. This then implies a question as to which one actually perpetuates the change in the other especially in the long run.

Jayachandran and Seilan (2010) studied the causal relation between trade, foreign direct investment and economic growth in India. The variables were found to be cointegrated meaning a long run relationship could be established. The findings using Granger-causality test revealed independency among the variables for the period 1970 to 2007.