

Abstract

The purpose of the study was to build a model to explain the effect of Total Factor Productivity on economic growth in Kenya for the period 1970-2015 after accounting for labour and capital productivity. ARDL bounds test of co-integration is employed and the Error Correction Model reveals that the Total Factor Productivity Components of Foreign Aid and Financial Development have insignificant effect on economic growth and null hypotheses are accepted, while Foreign Direct Investment has significant effect on Economic Growth and the null hypothesis is rejected. The significant Error Correction Terms reveal multidirectional causality between Foreign Direct Investment, Economic Growth and Foreign Aid while there is unidirectional causality between Economic Growth, Foreign Direct Investment, Foreign Aid and Financial Development. A robustness check is then carried out to determine the consistency of the ARDL findings using the Johansen test of co-integration, vector error correction model (VECM) and post estimation tests. The findings reveal consistency in the Error correction terms with (-.91) for ARDL and (-.87) for VECM. The orthogonalized impulse response functions show the effect of permanent and insignificant shocks for the variables. In conclusion to realise significant effect of the Total Factor Productivity components on Economic Growth, the recommended policy actions are to improve governance through public and private sector reforms and reinforce the powers of agencies such as the Ethics and Anti-corruption Commission (EACC), implement structural and economic reforms, lower transaction costs to businesses, and to improve policies for the adoption of technology.