

## THE MIGRATING NATURE OF FOREIGN DIRECT INVESTMENTS AND THEIR IMPACT ON ECONOMIC GROWTH

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**Abstract.** *The global economic crisis of 2008-2009 has reignited the debate concerning the pertinence of financial integration, both in industrially advanced and emergent economies as well. Thus, the crisis provides a new chance to revise the analysis comparing the international capital flows and economic growth. The foreign direct investments of the past few years have become increasingly important for the global economic activity, and the professional literature has developed a numerous number of hypotheses concerning the relationship between FDI and economic growth. The idea that the increased FDI inflows result in stronger economic growth is currently very topical in several debates. Some of the previously conducted research argue that FDIs can have both positive and negative effects on the GDP. The careful analysis of the effects that FDIs may have on economic growth in various economic sectors of the recipient country has resulted in various findings. FDIs can have negative effects on the economic growth prospects of the recipient countries when they lead to substantial reversed flows in the form of revenues from dividends or when multinationals obtain substantial privileges or other advantages in the recipient country. There are numerous research papers in professional literature that approach the relationship between foreign direct investments and economic growth. The research in the field has intensified in the past decade, due to the increasingly important weight of FDI in the total capital flows. The present research will analyse the relation between economic growth and the amount of international capital flows in order to identify to what extent foreign direct investments help increase the level of economic growth. The analysis we are suggesting encompasses the group of developed countries, developing countries, as well as those countries identified as transitioning during 1970-2013. The main objective of the present research is to identify and analyse systematic models in the relationship between FDIs and economic growth throughout a period that can be best described as accommodating a high level of financial integration.*

**Keywords:** foreign direct investments, financial flows, economic growth

**JEL classification:** F43, O16,

### **1. Theoretical background of the relationship between foreign direct investments and economic growth**

The empirical research of the effects of foreign direct investment flows (hereon known as FDI) on economic development have reached mixed results, contrasting the predictions of the "new growth theory" that suggested the fact that the emergence of new types of inflows, new technologies, new management and organisational models, as well as the probable growth of human capital accumulation rate as a consequence of FDIs should have a positive influence on economic growth (Marino, 2000; Romer, 1986, 1990; Grossman and Helpman, 1991). (Serhan, 2003)

Borensztein, De Gregorio, and Lee (1998) have found that the positive effects of foreign direct investments on economic growth depend on the development level of the financial market, of the infrastructure and of the human capital of the host country. They have tested the effect of FDIs on economic growth by using a regression model, based on the data concerning FDIs from industrialised countries to 69 developing countries during 1970 -

1989. Their findings have confirmed that FDIs favour technological transfer, which significantly contributes to the increase of internal investments. Moreover, their findings show that there is a higher efficiency of FDIs if recipient countries meet a minimum level of human capital. Thus, according to this theory, FDIs lead to economic growth only when the recipient country has a high absorption capacity of advanced technologies.

Alfaro, Chanda, Kalemli-Ozcan and Sayec (2004) have conducted an empirical analysis that allowed them to argue that the countries that have recorded a significant level of economic growth as a consequence of foreign direct investments were the ones that have well-developed financial markets.

Liu and Li (2005) have identified both the presence of a direct effect of FDIs on economic growth and an indirect effect that was a consequence of the interactions occurring in various sectors.

Other researchers have highlighted the fact that the positive effects are quite significant, depending on a variety of factors, such as “the development level of the recipient country”, “the training level of the human capital”, “the economic openness degree” or the specific sector that has attracted foreign direct investments (Alfaro, 2003; Borensztein et.al., 1998; Soysa and Oneal, 1999).

Foreign direct investments are generally seen as having a major impact mainly on the economic development of emerging markets. On the other hand, foreign direct investments are also very important for multinationals. Thus, both developed (initiating FDIs) and emerging economies have a common interest in encouraging FDIs, even though their objectives are different (Resmini 2000 Estrin and Meyer 2004). The positive effects of FDIs are important for recipient economies, while corporate growth and revenues are a typical objective for multinationals.

Professional literature presents conflicting evidence related to the question: how and to what extent do FDIs affect economic growth. FDIs can directly affect economic growth, as they contribute to capital build-up as well as to the transfer of new technologies in the recipient country. Moreover, FDIs stimulate economic growth indirectly, when the direct technological transfer increases the know-how reserve of the recipient country by training the workforce and by transferring new information, new management practices and new organisational structures. (Muawya, 2009)

The empirical evidence identified by Alfaro, Chanda, Ozcan and Sayek (2002) suggests that foreign direct investments play an important role in ensuring economic growth. Nevertheless, the development level of the domestic financial markets is essential for these positive effects to be felt.

The size of the GDP is one of the variables that also includes the effect of foreign direct investments in the recipient country. At the same time, a GDP increase per capita also increases the demand on the domestic market. Dornbusch and Fisher (1994) relate the demand of consumers to the available monetary supply for expenses, as the remittances sent by workers abroad to their country of origin are an important source of funds.

Bengoa and Sanchez-Robles (2003) argue that, in order to benefit from long term capital flows, the recipient country must make evidence of adequate human capital, sufficient infrastructure, economic stability and free markets. The idea that FDIs favour economic growth in recipient countries, provided that the latter is able to take advantage of its contingencies is also supported by the empirical findings of De Mello (1999) and Obwona (2001). Borensztein and collab., (1998), go even further and suggest that FDIs are an important instrument for technological transfer, playing an important role in encouraging internal investments. They use an endogenous growth model, where the technological progress rate is the main factor that favours the long term revenue growth rate.

Alfaro, L.(2003) shows that the benefits of foreign direct investments are highly variable for each economic sector. After conducting an empirical research for the period during 1981-1999, the author suggests that the total amount of FDIs exerts an ambiguous effect on economic growth. Foreign direct investments in the primary sector tend to have a negative

effect on economic growth, while those made in the secondary sector have a positive effect. As far as the tertiary sector is concerned, the relationship FDI-economic growth is unnoticeable.

## **2. Analysis of the relationship between foreign direct investments and economic growth**

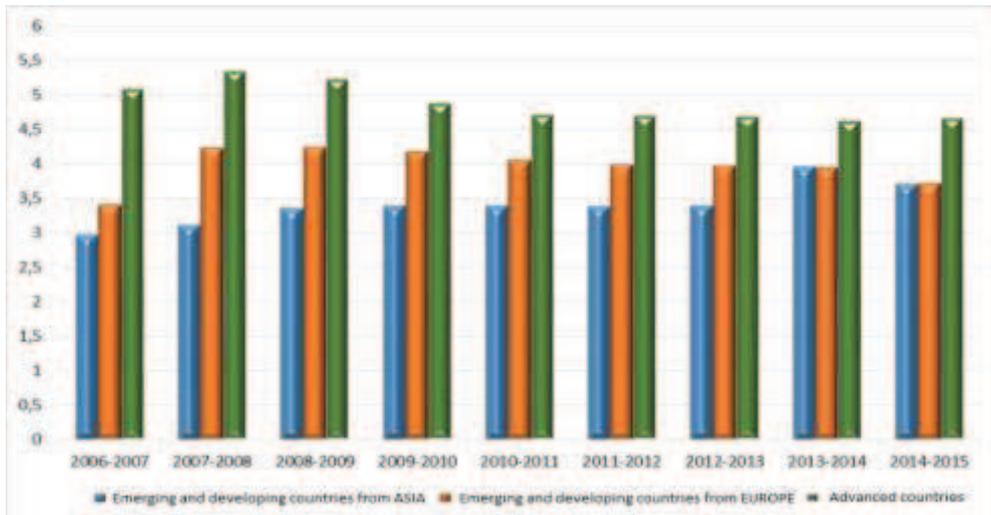
Foreign direct investments are taken into account when identifying one of the most important indices used worldwide, i.e. the Global Competitiveness Index (GCI). This index has been calculated since 2001 by the World Economic Forum based on 12 pillars of competitiveness, namely: institutions, infrastructure, macro-economic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication, research, development and innovation. The pillars are grouped into three categories: basic requirements, efficiency enhancers, innovation and sophistication factors, and are subsequently divided into 111 sub-indexes.

According to the Global Competitiveness Report 2014-2015, the economic growth recorded in the past few years can be attributed to the outstanding and bold monetary policies applied in countries such as the United States, Japan and the United Kingdom. As the economy improves in these countries, the normalization of the monetary policy with tightening of financial conditions could have an impact on both advanced and emerging economies. Thus, they estimate that emerging economies will undergo a more modest economic growth than before. The economic performance of these countries may be affected by a changing environment with significant difficulties in accessing capital, as well as lower prices for goods that have favoured the growth trend which is in turn likely to affect many developing countries.

The financial market development is an important pillar used in assessing the global competitiveness index. The occurrence of the financial and economic crisis has outlined the increased importance of stable financial markets for the development of business activities. A properly functioning financial market ensures the increased productivity of the financial resources on the domestic market, as well as of those fuelled by foreign markets.

**Figure nr.1** presents the evolution of the scores reached by the group of emerging and developing countries in Asia and Europe, as well as the group of advanced industrialised countries for the pillar "*Financial market development*", for the period 2006-2015.

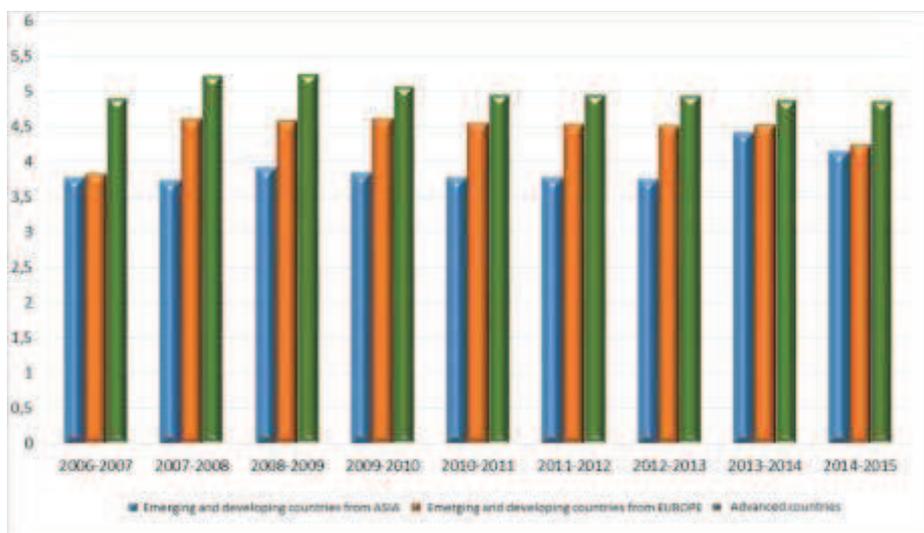
According to the classification drawn by the International Monetary Fund (World Economic Outlook, April 2014), we can refer to the group of countries with an advanced economy, the group of emerging countries and developing countries in Asia and Europe. (IMF, 2014)



**Figure 1:** Evolution of the scores reached for the pillar *Financial market development*, per group of countries during 2006-2015

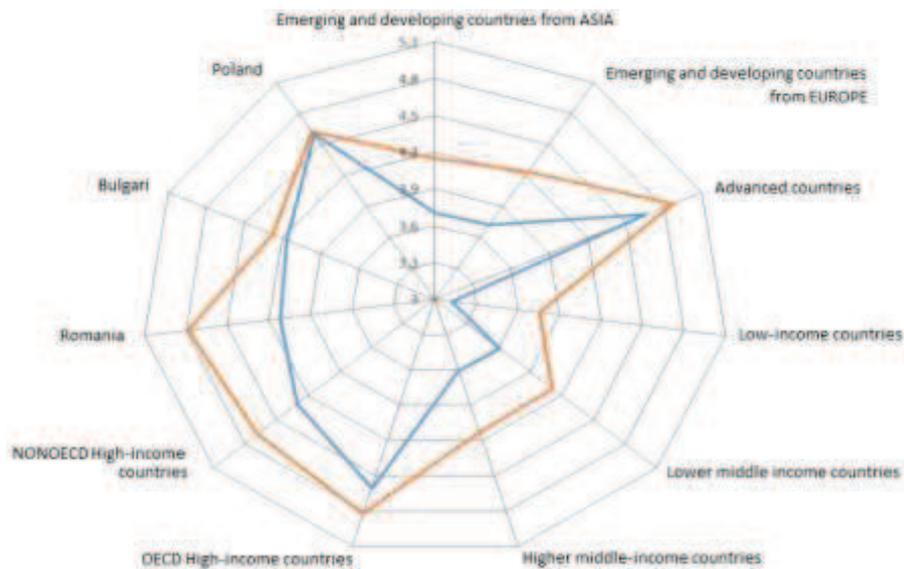
Source: author's own, processed based on the data from *The Global Competitiveness Report, 2014-2015*

The analysis of the evolution of the scores reached per group of countries during 2006-2015, both for the “Financial market development” (Figure no. 1) and for the sub index “Foreign direct investments and technology transfer” (Figure no. 2), highlights the tendency of emerging and developing countries in Asia and Europe of catching up with advanced industrialised countries in terms of the performance of the “financial market development” pillar.



**Figure 2:** Evolution of the scores reached per groups of countries during 2006-2015, for the pillar “FDIs and technology transfer”

Source: author's own, processed based on the data from *The Global Competitiveness Report, 2014-2015*

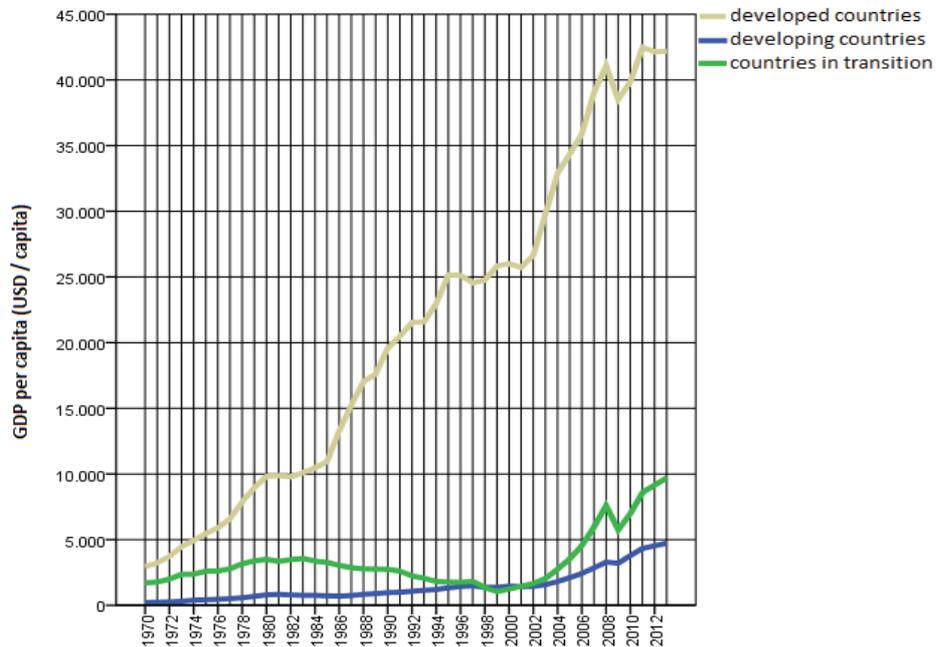


**Figure 3:** Scores reached for the pillar *Financial market development* and for the pillar *FDIs and technology transfer* in 2014

Source: processed based on the data from: *The Global Competitiveness Report 2014 - 2015*

An analysis of Figure no.3 reveals that Poland sets itself apart from the group of emerging and developing countries in Europe, due to its economic growth based on well-developed financial markets, reaching the highest score for “financial market development” after 2009 (4,7). As far as Romania is concerned, note that, even though the score reached for foreign direct investments is even higher that Poland’s, reaching a value of 4,8, the financial market development score is rather low (score of 4,0).

The evolution of the GDP (Gross Domestic Product) per capita, during 1970-2013 per group of countries according to development level, as measures by UNCTAD, is presented in Figure no. 4.



**Figure 4:** Evolution of the GDP per capita, for each group of countries, during 1970-2013  
 Source: author's own, processed based on the data from UNCTAD, Database

The analysis of the GDP per each main group of countries reveals the presence of a massive delay between the economic growth recorded in developed countries and that recorded in developing countries, even though the latter have undergone significant progress during the period analysed according to the data presented in Figure no.4. Foreign direct investments are one of the factors influencing economic growth, and the effects are more visible in developing countries.

Even though a global growth of 3,5% is estimated for the period 2015-2016 (according to the data presented in Table n.1), declining by 0,2% as compared to the figure estimated in 2014, this forecast also takes into account the reassessment of the prospects in China, Russia, the Eurozone and Japan, as well as the decreasing economic activity in the oil exporting countries, as a consequence of the declining oil prices. (IMF, 2015)

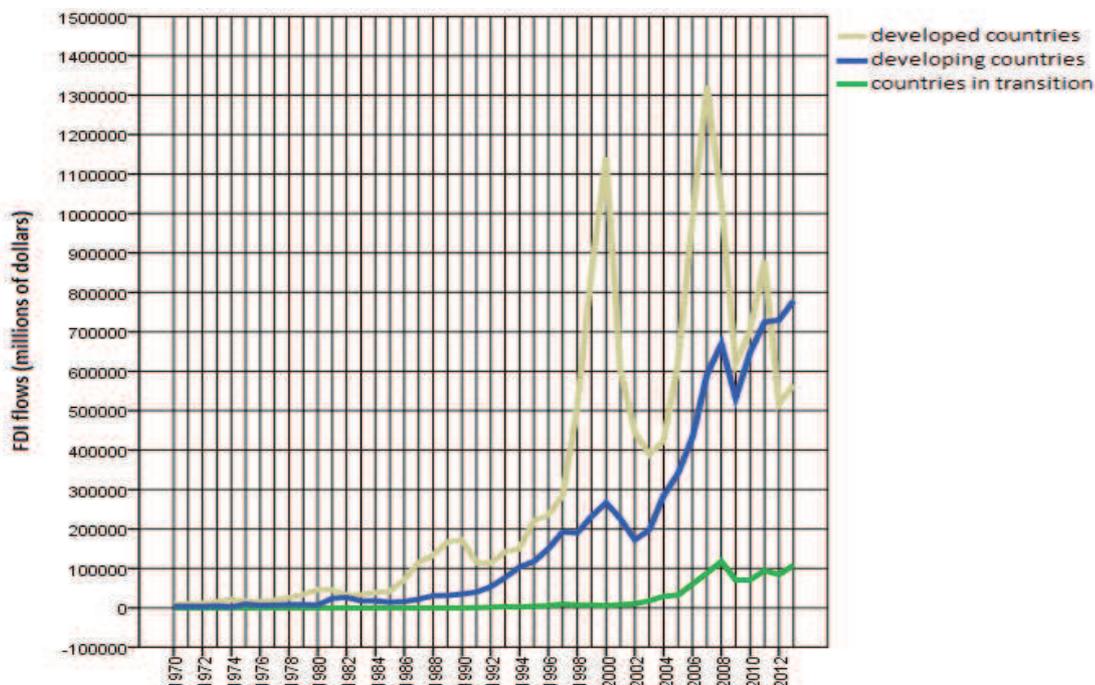
**Table 1:** Evolution of economic growth on a global scale

	2013	2014	2015 e	2016e
<b>Global growth</b>	<b>3,3</b>	<b>3,3</b>	<b>3,5</b>	<b>3,7</b>
<b>Advanced economies</b>	<b>1,3</b>	<b>1,8</b>	<b>2,4</b>	<b>2,4</b>
United States	2,2	2,4	3,6	3,3
Eurozone	-0,5	0,8	1,2	1,4
Germany	0,2	1,5	1,3	1,5
France	0,3	0,4	0,9	1,3
Italy	-1,9	-0,4	0,4	0,8
Spain	-1,2	1,4	2,0	1,8
Japan	1,6	0,1	0,6	0,8
Great Britain	1,7	2,6	2,7	2,4
Canada	2,0	2,4	2,3	2,1
Other advanced economies	2,2	2,8	3,0	3,2

<b>Emerging markets and developing countries</b>	<b>4,7</b>	<b>4,4</b>	<b>4,3</b>	<b>4,7</b>
Commonwealth of Independent States	2,2	0,9	-1,4	0,8
Russia	1,3	0,6	-3,0	3,2
Outside Russia	4,3	1,5	2,4	4,4
Emerging and developing countries in Asia	6,6	6,5	6,4	6,2
China	7,8	7,4	6,8	6,3
India	5	5,8	6,3	6,5
ASEAN	5,2	4,5	5,2	5,3
Emerging and developing countries in Europe	2,8	2,7	2,9	3,1
Latin America and the Caribbean	2,8	1,2	1,3	2,3
Brazil	2,5	0,1	0,3	1,5
Mexico	1,4	2,1	3,2	3,5
Middle East, North Africa, Afghanistan and Pakistan	2,2	2,8	3,3	3,9
Saudi Arabia	2,7	3,6	2,8	2,7
Sub-Saharan Africa	5,2	4,8	4,9	5,2
Nigeria	5,4	6,1	4,8	5,2
South Africa	2,2	1,4	2,1	2,5

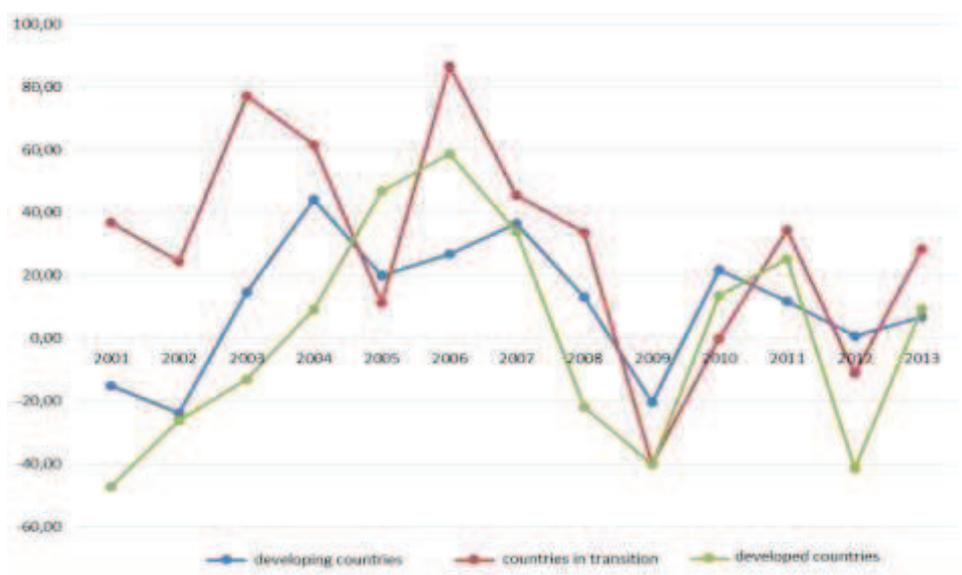
Source: author's own, processed based on the data from World Economic Outlook, January, 2015

According to the International Monetary Fund (WEO, 2015), the risks of the global economy are mainly related to the changes in perception and to the volatility manifested on global financial markets, particularly on emerging markets, where the lowered prices for oil have led to the occurrence of certain external vulnerabilities. At the moment, both stagnation and the low inflation are important concerns in the Eurozone and Japan.



**Figure 5.** Evolution of the inward FDI flows, per groups of countries, during 1970-2013  
Source: author's own, processed based on the data from UNCTAD, Database

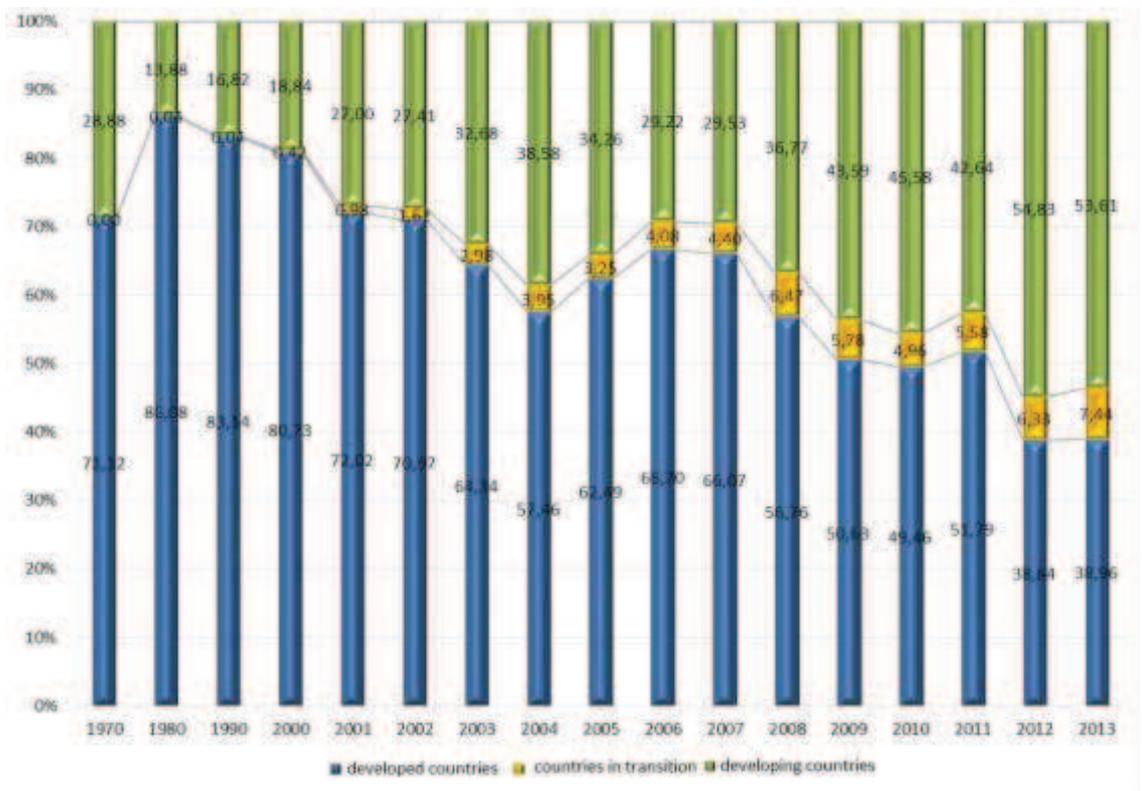
As concerns the evolution of inward FDI inflows per groups of countries, during 1970-2013, developing countries have globally overtaken developed countries starting with 2010. In developing and transition economies, the growth was mainly triggered by the acquisitions made in Central America and the Caribbean, as well as by the inflows recorded in the Russian Federation. The FDI inflows have increased globally by about 9% in 2013, this increase being recorded in all groups of countries – developed, developing and transition economies.



**Figure 6:** The growth rates of the inward FDI flows, per groups of countries, during 2001-2013, as compared to the previous year

Source: author's own, processed based on the data from UNCTAD, Database

An analysis of the graph presented in Figure no.6 reveals that FDI flows to developed economies have increased as compared to 2012, ranking at only 43% of the maximum level reached in 2007. Even if the growth rate of FDI flows to developed countries has been higher, as compared to developing countries in 2013, it still wasn't enough to reinstate their position as main recipients of inward FDI flows. The ratio of developed countries to the total foreign investments amounts to just 39% in 2013, as compared to the weight of developing countries, that has reached a ratio of 53% of the total inward FDI flows on a global scale, according to the data presented in Figure no.7.



**Figure 7:** Structure of the global inward FDI flows during 1970-2013, per groups of countries

Source: author's own, processed based on the data form UNCTAD, Database

The analysis of the above presented graph reveals the increasing weight held by transition economies (from 0,04% in 2000 to approximately 7,5% in 2013) , as well as the ratio held by developing countries (from 19% in 2000, to about 54% in 2013), in the global inward FDI flows. Thus, in 2013, developing countries accounted for more than half of the inward FDI flows on a global scale (54%), as compared to the ratio held by developed countries (39%) according to the graph outlined in Figure no.7.

### 3. Conclusions and future research prospects

The analysis of the evolution of economic growth for each main group of countries has revealed the presence of a substantial disparity between developed and developing countries, even though the latter have recorded important boosts in their economic growth level throughout the period under analysis.

The FDI have increased globally by about 9% in 2013, and this accretion has been recorded in all groups of countries: developed, developing and transition economies.

Foreign direct investments towards developed countries increased as compared to the previous year, but have amounted to 43% of the level they had reached in 2007. Even if the growth rate of FDIs to developed economies has been more accelerated as compared to inward flows to developing economies in 2013, this hasn't been enough to reinstate their position as main recipients of FDI inflows. (The weight of developed economies to the total foreign direct investments accounted for only 39% in 2013). Thus, we have identified an increased ratio of transition and developing economies to the total global inward FDI flows. (In 2013, developing countries held more than half of the amount of inward FDI flows).

The considerable uncertainty threatening the global economic environment as concerns the future evolution of the oil price, as well as other factors that lead to falling prices, have brought about a new type of risk for the economic growth perspectives worldwide. In our future research, we will focus on the correlation between FDIs and economic growth for each group of countries, by employing the graphical method, as well as the regression and correlation method.

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