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THE REAL RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH

ІСТОТНИЙ ВЗАЄМОЗВ'ЯЗОК МІЖ ПРЯМИМИ ІНОЗЕМНИМИ ІНВЕСТИЦІЯМИ ТА ЕКОНОМІЧНИМ ЗРОСТАННЯМ

Summary. This paper deals with the real relationship of FDI and economic growth. The author investigated the direct positive impact of FDI in boosting economic growth for the host countries. He determined this impact on macro- and micro-economic levels. The author also described the indirect effect of FDI on the economic growth. At the end of this paper, he investigated vertical and horizontal studies on indirect effect over productivity.

Key words: foreign direct investment, economic growth, relationship, direct, indirect, macro level, micro level.

Introduction. The relationship between economic growth and FDI has been a well-studied subject in the development of economics literature. As a matter of fact in recent years, the interest in this subject has grown regarding the substantial increase in the FDI flow, which started in the late 90's and leads to a wave of research regarding this subject; Al-Iriani [3]. Moving on FDI (Foreign Direct Investment) simply means a transfer of capital investment to a host country by private foreign enterprises, according to Effendi and Soemantri [10].

The FDI was considered as an important element or resource for the economic development. There are many arguments on the flow of FDI that says [22] the flows of FDI could perhaps fill the gap between desired investments and domestically mobilized saving. In addition, it may improve the management technology, and labour skills in the host countries as well.

Research Objective. This paper discusses some conflict within FDI as to what extent FDI affects the economic growth. But still the empirical evidence suggests that the FDI plays an essential or important role in contributing to economic growth. On the contrary, there are some indications that the effect of FDI on total factor productivity has been lower than domestic investments in some of the countries over the period studied, indicating a possibly dominating negative crowding out effect. However, the studies indicated that there is more than one factor of the FDI that depends on the growth effect, such as the degree of complementarity and substitution between domestic investment and FDI, and other country-specific characteristics.

The research. Krogstrup and Matar [19] stated that FDI in Arab countries increased in the 1990s, and in 2002 this development increased more and more following the global economic decrease, which started in 2001. But FDI flows to improving countries have recently become active again and continue to be the most important source of foreign financing in the developing world by lot of types of private capital inflows like bank deposits, they tried to explore how much the FDI absorptive capacity and growth increased or decreased in Arab countries, and compare between the past and present analysis. And the results showed that Arab countries had a very small fraction of FDI, and this fraction did not increase sense 1990s; FDI has been contributed to the Arab region with the little growth to the fixed capital formation in the region. FDI may have a positive impact; more recent research indicates that there FDI can show negative sides. This analysis is made in four different aspects of absorptive capacity: technology gaps, education levels, financial sector, and institutional development; this analysis show that GCC, Lebanon, and Tunisia are not likely to pass the benefit from FDI but the analysis had made one point very clear: Arab countries would benefit from implementing policies to improve and absorb FDI, these benefits will be an upgrade of human capital stocks, improvement in the educational system, financial sector, and many others.

According to Hussein [16], although GCC countries receive a small fraction of total FDI flows and the results of the studies showed or indicated a weak relationship between FDI and GDP in the panel of the GCC. They should be more eclectic toward attracting FDI as they have abundant financial resources and domestic investments as well. Nevertheless, the flow of FDI has a great potential to higher the growth by efficiency in the physical and human capital, diffusing technology, and improving entrepreneurial skills. As such efforts are needed in order to attract FDI and improve growth.

On the other hand, expected spillovers of inward foreign direct investment (FDI) have motivated governments in many transition economies to adopt policies aimed at attracting investors. These countries have to modernize their industrial structure, upgrade their infrastructure, and acquire new capabilities to flourish the capitalist market economy. The restructuring of enterprises is thus a core element of economic transition and a central issue in economic research on transition [17]. It is widely recognized that FDI plays an important role in this process of restructuring the former centrally planned economies by providing a vital source of investment for overcoming the situation of a collapsing state sector and a slowly growing private sector, and by contributing managerial skills, new technology, capital, and competition [20]. These contributions are expected to benefit not only the foreign-owned business but also domestic firms that come in contact with the foreign-owned entity.

Scholars have attempted to show the positive or negative effects of FDI on the local industry to provide a basis to assess policy measures. So far, results have been mixed for both developing [14]. Yet few studies have explored, under which conditions such externalities occur. In this study, we provide new evidence on the size of technology spillovers on the productivity of local firms, and on the industry conditions that favour these spillovers.

Scholars have used two approaches to estimate spillover effects of FDI, using industry level data or firm level data. Studies of the first type present evidence on the positive effect of foreign presence on the labour productivity of local firms, and confirm on the basis of aggregate data that spillovers are significant across industries [8].

Studies of the second type employing firm level data provide no or negative evidence of spillovers to domestic firms. For instance, Haddad and Harrison [14] examine the effect of foreign presence on the relative productivity of local firms (i.e. comparing the firm level productivity with that of the best practice firm in the industry). Using data for Morocco, they find no evidence of spillovers. However, competition seems to push local firms toward the best practice frontier in industries with the low level of technology. Hence, spillovers do not always take place in all industrial sectors. Harrison [14] finds negative spillovers, which they refer as "market stealing effect", i.e. foreign investment reduces domestic plant productivity in the short run by forcing domestic firms to cut production. In addition, they also test for the possibility that spillovers are "local". However, they find almost no evidence to support this claim.

According to research findings of Klaus Meyer [20], spillovers from technology transfer depend on the measure of spillovers used. Furthermore, they depend on firm size, its ownership structure, domestic firm trade orientation, and their proximity to foreign firms. In addition, spillovers of technology transfer benefit from the competition of foreign firms as it makes domestic firms to use their existing technologies more efficiently, or search for new ones to maintain their market shares. Moreover, although possessing skilled labour increases output growth, its movement toward foreign firms significantly harms the indigenous firm output growth. Furthermore, by investing local firms in intangible assets, in new machinery, and equipment, could benefit the domestic firms in higher output growth. However, this is not sufficient for domestic firms to benefit from the advanced technology of foreign firms, especially when the industry is characterized by large shares of foreign firms in employment, sales or equity. In addition, we find that state owned and outsider owned firms benefit from spillovers of technology transfer, whereas insider owned firms experience strong negative spillovers.

The policy implications for the host country governments would be to foster competition as it induces domestic firms to be more efficient in using the existing technology or search for new technology so that they keep their existing market share. Domestic firm's benefit is more from an increase in foreign share in employment or sale, rather than an increase in foreign share in equity, the host country government should create incentives for foreign firms to employ mainly local workers and invest in their training. This would reduce the movement of skilled workers from domestic to foreign firms. Moreover, for the country itself, it is important to possess educated people as this is necessary for the domestic firm output growth and for benefiting from the advanced technology of foreign firms.

The direct impact of the FDI on economic growth: The researchers have found in their studies that FDI and multinational corporations have a positive impact in boosting economic growth for the host countries. And they have done that by increasing the saving of the countries and their amount of capital. So, the FDI improve the economic condition of the country by their capital accumulation, and this can be done by several ways such as bringing new and unique products to the market that can attract a large number of customers, hiring new and developed technologies that are imported from foreign countries, which has improved their production technologies and process. They also have benefited from using and accessing to low-cost raw material and labour. Moreover, they have noticed that the accumulation of capital is affected by the level of the economic growth in the short term by the exogenous factors, while, in the long run, they have noticed that the advanced technology provided by the FDI is the main important factor that affected the economic growth. The FDI considered a very important factor in strengthening the host countries abilities in various fields, especially their economic situation compared to the domestic investments, and this is because of the unique and new skills they have got, resources they have obtained, and the knowledge they have improved. That is why the host countries should encourage and attract the FDI because it will help them significantly to develop and improve their economy more than their traditional investments as it has a wider knowledge, more efficient and effective techniques, and many special skills.

However, some researchers have done a hypothesis which shows that it is not necessary that the foreign investments have a higher performance than the domestic firms. There they assumed that not only the skills and knowledge makes the foreign investment better than the domestic ones but there are other factors that can make them perform better such as their financial situation. And this is the reason that attracts them to invest in other countries to enjoy a lower cost of resources and entering a new market; Borensztein et al. [6]. Some researchers like Herzer et al. [17] claims that real impact of the FDI on the economic growth is not defined in an accurate way. Therefore, they have designed two different studies to measure that effect on the economic growth. The first one is by focusing on issues such as the GDP, which is the macro level. And the second one is by focusing on the relationship between FDI and the level of productivity.

Macroeconomic and microeconomic level: According to macroeconomic level, studies show that FDI can impact and effect on economic growth. FDI inflows affect the economic growth positively in the host economy, for example, FDI is expected to be higher in export promoting than in import substituting countries. This relies on many factors such as the level of income, financial development, human capital development, infrastructure development, the degree of openness, and institution development. They tested the hypothesis for 46 developing countries. They found out that since the openness is crucial in measuring the effect of FDI on economic growth as the countries are more honest, the benefit will increase. Countries that have excellently developed financial markets will be more favourable to be affected by the FDI [2].

FDI can positively affect the economic growth of the manufacturing sector while the primary sector will be affected negatively and the service sector will have unclearly affected. However, high-income developing countries used to have more beneficial FDI rather than low-income developing countries. Due to these studies, the host country should have a certain level of development to reach a higher level of benefit. There are different types of studies applied to determine the FDI; one of them is cross-country techniques, which can result in different effects of FDI on economic growth between the studies, which is due to the different production functions as technological techniques can vary from one country to another. However, traditional panel techniques are the other type of studies that was applied and used to escape the problems associated with cross-country studies. In addition to studies recorded that the economic growth has no direct effect from the FDI and the private investment, while state-owned investment has a direct effect on economic growth. The total factor productivity (TFP) can be increased significantly by the FDI but this has no impact on the private or state-owned investment. FDI has indirect positive effect by affecting technological progress and DI on the economic growth, not through direct effects. Moreover, panel integration techniques are used to avoid the criticisms of traditional panel data estimators.

At the microeconomic level, the researchers have focused to analyse the data according to industry level, which focused on testing the hypothesis of assuming that the foreign investments and companies have better characteristics such as the level of technology compared to the domestic or local firms. In a study that was conducted in Venezuela to test their plants, they have found that foreign investment in that field has increased the productivity. In addition, some studies reached to results that considered the foreign direct investments firms more effective and efficient in performing their functions than the local firms and this is because of multiple reasons such as higher levels of technology, advanced managerial skills, and their financial condition. Another study done by Smarzynska [21] conducted in Lithuania shows that there is a positive relationship between the level of performance and productivity of the domestic companies and their dealing with diversified customers.

However, they have found that there is no relationship between the existing of FDI companies in their sector and their level of productivity. Furthermore, Gorg and Greenaway [13] found that existence of FDI companies could have a negative impact on the domestic firms, in which creating competition between domestic and FDI firms made some of the domestic firms to lose its capital and reduce its manufacturing and producing level as the FDI firms will have more superior elements and power over the domestic firms. Another study that has been done in Indonesia found that the foreign investments in host countries are having a high level of advanced technology that can help them to gain a competitive advantage over the domestic firms.

The indirect impact of FDI on economic growth: Different developing economies have been given specific treatment by conducting foreign projects. Understanding the desire to import technologies that are not manufactured by local firms is made by the countries; they try to attract Multinational Corporations MNC's, so they can earn new technologies and employees skills from the MNC's [5]. The characteristics of FDI daffier between the sector, so it is not earning and provide benefits at the same level to all sectors, organizations, and domestic societies. FDI, in particular, include a combination of tangible, as well as intangible assets [9]. This package of the asset will not only increase the output and development in the new entrants of MNC's, in addition, it may also overflow to other companies in the country that is hosting. The significant influencing force, which attracts MNC's and associated FDI to the economy of the hosting country, is the boost of the local company's productivity. Two researchers, which are Blostorm and Kokko [9], had an argument that the affiliates set up by MNC's out of the home country are distinct from those companies in the host economy for two mains reasons.

First, MNC's gives to the host economy some total of their proprietary technology, which shapes their company's specific feature allowing them to compete against other local companies.

Second, the MNC's entry and being present annoys the existing equilibrium in the market, as well as this will enforce the local companies to protect their market shares by taking serious actions. Markusen argued that the horizontal FDI means the foreign manufacturing of goods and services approximately same to those the company manufactures for the local market. Also, Soreide [16] mentioned that the horizontal FDI is supposed to produce more positive spillovers than vertical FDI, especially when MNCs supply a domestic market in the host economy.

Rodriguez-Clare said that MNCs has a great influence on the host economy through three different ways, which are transferring technology, training given to workers, and generation of linkages.

So, from the above studies we can conclude that the technology transfer considered the major indirect impact on the economies of the host country, many researchers go deeper to explore the case, Glass and Saggi [12] shows how the quality of technology transferred through FDI is linked through the technology gap. To the rate of imitation relative to innovation by studying parameters that determine how much FDI occurs to produce using the best technology available.

The larger the market for high-quality levels of products or the larger the resources in the North relative to the South, the smaller the extent of high-quality FDI. However, the larger the resources required for the innovation relative to imitation or the larger the cost disadvantage of multinationals relative to Southern firms, the larger the extent of high-quality FDI. The host country can shrink the technology gap and thus encourage high-quality FDI by imposing a tax on low-quality FDI production or providing a subsidy to imitation. Encouraging domestic R&D activities that push forward the technology frontier releases the constraints faced by Northern firms wanting to produce using advanced technologies in the South. Such policies improve Southern welfare by raising Southern wages, lowering prices and accelerating innovation. It is concluded that in situations where a substantial technology gap persists between the source and host countries, imitation can provide the technological foundation needed to make state-of-the-art technology transfer through FDI more attractive from the viewpoint of Northern firms.

The emerging markets transfer technology with the increased productivity and the lower input prices. There has been technology, which induces the entry and the competition in the market. The usage of the panel dataset is where the outputs and the profits are focused on to increase the supply to the supplier and the buyer sectors [2].

The horizontal and the vertical technology transfer are for the handling of the foreign and the domestic firms in a market, which varies. There have been products where the multinationals products are for the export [4]. There have been differences in the qualities of the export and the domestic goods consumed. The entire setup has been to handle the multiple sources of the supply, which encourage the entry competition with the lower price range [18]. The total surplus rises due to the new technology with the increased productivity and, thereby, there is a decrease in the imperfect competition.

As according to the research of Blalock and Gertler [4], there have been downstream FDI increases in the output with the additional firm value of the firms, which are upstream. There is a decrease in the price and the market concentration when it comes to the markets in the upstream. There has been an increase in the output with the firm value addition of the downstream firms and the decreased price with the market concentration has been set for the supply of multinationals.

The findings mainly suggest the FDI, which leads to the Pareto improvement in the welfare along with the benefits to the different consumers with the lowered price rates. Results in the advantages for the various customers related to the lower price patterns with a higher value addition, which has a higher transmission and the down transmission of the technology, which has been brought by the FDI. With the empirical study, Harrison's examination in 1995 for the factory of Venezuela find that there have been adverse effects, which could be seen for the local firms and these are resulting in the attributes that add to the influence of the foreign competition. The other methods hold the panel dataset for the factories, which include the production function estimation.

There have been two significant implications where the FDI has been seen to be the only source for the different emerging markets. The other implication is where the technology can generate the welfare benefits, which may be able to warrant the public policy intervention. There have been econometric analysis and the other interviews, which suggest the vertical supply chain management for the technology transfer [4]. The productivity growth and the other experiences are the incentives of the enterprise in the multinational sectors to realize about the investments and to procure the higher quality of the inputs at a much lower cost. The observations and results are mainly for the information to the public policy. The entire results are based on the benefits of FDI, which have been internalized by the private parties where there has been no intervention by the government. The results of the FDI show that there is a need to generate the externality where are lower price rates with the finalized real makers and the consumers. These can handle the FDI benefits to the economy, which will lead to the deployment by the host economic policy.

The channels of international technology transfer and their importance for growth knowledge spillovers to developing countries [5] think about offering experimental confirmation on the significance of FDI streams for the company's efficiency higher profitability levels and development. These studies utilizing firm level board information overflows, the proof on innovation overflows from a neighbourhood. Recently, there is likewise a developing writing on FDI overflows on the move might be critical for exchanging innovation to a subsidiary, however, gives no proof of even overflows to nearby firms in Bulgaria, Poland, and Romania. Djankov and Hoekman additionally give a confirmation that negative overflows give proof of overflows in the Czech Republic from 1995 to 1998, yet they on the availability of global learning of overflows by neighbourhood firms open to foreign capital, gain significant direct technology transfer through FDI, a study on eight transition countries using static panel data approach and also the effects of international R&D spillovers at the firm level; this paper, therefore, is to provide a comparative study on importance of spillovers of different channels of international technology transfer for firms in FDI transition from the parent firm to local affiliates, as well as horizontal vertical spillovers productivity for local firms.

Spillovers are found to be higher by factor 10 relative to horizontal spillovers, accounting different measures of spillovers at the firm level, innovation hole between outside partners and nearby firms, while the examination of overflows, for example, home business sector overflows, level, and vertical overflows from ways how information overflows from remote offshoots can build specialized change overflows, or even overflows, as the offer of an industry's yield delivered. In the following stride, we represent potential vertical spillovers of foreign affiliates. Potential to create positive spillover effects to local technology spillovers through FDI can occur between firms that are vertical while there is only a weak evidence of spillovers to indigenous firms. Significant technology transfer to the affiliates and some positive spillovers capacities are shown that allow firms to take advantage of the technology spillovers, those linkages between foreign owned firms and local firms, spillovers between foreign affiliates and local firms.

Vertical and horizontal studies on indirect effect over productivity: Many researchers were interested in studying the indirect effects of the FDI to the local businesses through the use of horizontal productivity. For example, Gorg and Greenway [13] have done a study to test some factors like salaries and productivity, and they have collected their information based on 40 studies that were conducted and focused on the horizontal indirect effect over productivity. And they have found that a half of these studies confirmed that the FDI has a positive impact on the domestic companies. An example of a study that emphasizes the accuracy of this theory is one that was done by Caves [8], in which he collects data from multiple companies in Canada and Australia, and he found that foreign direct investments bring new and unique technologies, resources, and techniques that increase the level of competency of the domestic firms.

Moreover, the researchers have found that using panel data in their studies is providing more accurate information and results than using the cross-sectional data. However, some studies in multiple countries like Haddad and Harrison [14], found that the FDI has no a positive indirect impact on the domestic companies, because they discover that high level of performance enjoyed by the foreign investors will reduce the opportunities for the local firms to increase their productivity and thus increase their profits.

Furthermore, there is a study that was done by Smarzynska [21], in which he collects information from some companies in Lithuania, and he found that there is a vertical positive impact of FDI on the domestic firms, in which it was observed that the FDI helps the local companies to adapt to new techniques and skills that can help them to be more developed and improve their performance and reputation in the market.

Conclusions and further research perspective. Stability, economic growth, and development have played a major role in attracting foreign investments to host countries, as investors aspire to maximize the level of return on their investment, in which the FDI can help them access lower material and labour cost. Also, it gives them a chance to enter new markets. The multinational corporations can make a foreign direct investment in other countries by different ways, such as the vertical foreign direct investment, which primary goal is to get an access to an excellent quality raw material at lower prices, as well as hiring of low-cost labour compared to another regions in the world, which can contribute to increased productivity, which will allow them to reduce their cost of manufacturing and, therefore, increase their profits and return on investment. The second one is the horizontal foreign direct investment, which aims to get the opportunity to enter new markets and compete with new rivals. And this has given them chances to diversify and access to a large number of consumers in different places.

Moreover, researchers discuss the relationship between the amount that the GDP is growing and the attraction of the host countries to FDI, in which GDP effect can affect decisions of foreign investors to establish their business in other host countries. In addition, their economic growth will result in increasing the demand for foreign direct investments because they will require more capital, so this will give opportunities to foreign investors to achieve their goal to reach a maximum amount of customers to serve and make the things they are producing globally accessible.

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Анотація. В статті автор провів ґрунтовний аналіз взаємозв’язку прямих іноземних інвестицій та економічного зростання. Він дослідив значний масив іноземної літератури з цього питання. В дослідженні аналізується прямий взаємозв’язок ПІІ та економічного зростання. Крім того він описується, як на макро-, так і на макрорівні. Окрему частину роботи автор присвячує опосередкованому впливу ПІІ на економічну систему.

Ключові слова: прямі іноземні інвестиції, економічне зростання, взаємозв’язок, прямий, опосередкований, макро рівень, мікро рівень.

Аннотация. В статье автор провел существенный анализвзаимосвязи прямих иностарнных инвестиций и экономческого роста. Он исследовал значительный масив иностранной литературы.В исследовании анализируется пряма взаимосвязь ПИИ и экономического роста. Кроме этого он описыветстя как на макро- так и на микро уровне хозяйствования. Отделая асть статьи посвячена опосредованному влиянию ПИИ на экономическую систему в целом.

Ключевые слова: прямые иностранные инвестиции, экономический рост, взаимосвязь, пямой, опосредованный, макро уровень, микро уровень.