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The impact of foreign direct investment (FDI) on the sustainable economic development

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Abstract

China has become an economic giant in the world due to its mega, advanced and innovative economic policies. This research covers the same thing, which describes the impact of Foreign Direct Investment (FDI) on the sustainable economic development in China. We compare Chinese data with other developed and developing countries, and then we come to know that FDI proves itself a force in the economic growth of China most importantly in industrialization field. Considerable and helpful results are found for the connection of FDI with economic growth in China, and also for the sustainability of the relation.

Keywords: Foreign Direct Investment China, FDI China, Impact of Foreign Direct Investment, Impact of FDI.

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El impacto de la inversión extranjera directa (IED) en el desarrollo económico sostenible

Resumen

China se ha convertido en un gigante económico en el mundo debido a sus políticas económicas megas, avanzadas e innovadoras. Esta investigación cubre lo mismo, que describe el impacto de la Inversión Extranjera Directa (IED) en el desarrollo económico sostenible en China. Comparamos los datos chinos con otros países desarrollados y en desarrollo, y luego llegamos a saber que la IED demuestra ser una fuerza en el crecimiento económico de China, lo más importante en el campo de la industrialización. Se encuentran resultados considerables y útiles para la conexión de la IED con el crecimiento económico en China, y también para la sostenibilidad de la relación.

Palabras clave: Inversión extranjera directa China, IED China, Crecimiento económico sostenible en China, Impacto de la inversión extranjera directa, Impacto de la IED.

1. INTRODUCTION

Over the past 20 years, with the globalization of the manufacturing and utilization of goods and services, international foreign direct investment (FDI) has experienced a marvelous improvement in trade regarding FDI in Sustainability. FDI inflows have developed at a regular annual rate of almost 25% during the last decade. According to researches, it is extensively implicitly assumed that FDI will not only show the way to the combination of innovative technologies, management strategies, and workforce practices, but also it will also help out to create new jobs, and on time economic growth in beneficiary countries.

However, in academic world, as Mello (MELLO, 1999) points out, the investigation for the keys to economic growth has been demanding in the economic literature. There have been contradictory investigation results as to whether FDI is the engine of economic development. Mello (MELLO, 1999) discovers that FDI is predictable to make advance and long-run growth in the beneficiary economy via technological exchange and information spillovers. But, the degree to which FDI is growth-increasing depends upon the extent of complementarily and substitution in between FDI and domestic savings. Carkovic and Levine (CARKOVIc, and LEVINE, 2002) find that FDI does not apply a vigorous, self-governing impact on growth at all. Loungani and Razin (LOUNGANI and RAZIN, 2001) recommend that FDI has a helpful impact on developing host countries with some possible risks.

Borensztein, Gregorio, and Lee (BORENSZTEIN, Gregorio, and LEE, 1998) show that FDI is serving relatively more in the growth of country than in domestic investment. Gardiner (GARDINER , 2002) also proves that the impact of FDI is always depends upon what shape it takes and providing a range of positive and negative factors of FDI as a basis for development. Mansfield and Romeo (MANSFIELD and ROMEO, 1980) investigate that FDI does not rotate the situation for growth. Alfaro, Chanda, Chanda, and Sayek (ALFARO, CHANDA, CHANDA, AND SAYEK, 2002) find that FDI plays a confusing role in contributing to economic growth. Calvo and Sanchez-Robles (Calvo and SANCHEZ-ROBLES, 2002) recommend that FDI in positive way

correlated with economic growth in the host countries of the example considered.

In this research, we make a graph for recent progress in the theory of foreign direct investment to find empirically significant determinants of economic growth in China. By using the statistics from China and other countries as well as making functions that based on domestic capital, foreign direct investment, work force, sell to other countries, we will learn that how foreign direct investment plays a role in economic growth in wide-ranging, and most importantly in China, if we relate it to the input of foreign trade to economic growth. The country-specific time chain information and cross-country panel information will be examined to ascertain the effects of foreign direct investment on economic growth.

The conclusions of this article advocate that FDI is a most important element of open macroeconomic growth and an important component for open economy also. In this paper, there are some findings 1) FDI proves itself a force in economic growth, most importantly in the later phase of industrialization; and 2) FDI is a balancing component in an open macroeconomic stability. Particularly, this study finds that country's foreign trade is an engine for the starting phases of economic growth, while foreign direct investment is the major player in the post-industrialization phases. This paper is prepared as follows. Initial section reviews the theory of foreign direct investment and growth; next section discusses the relationship between

FDI and economic growth; and last section provides results and conclusions.

All activities involved in FDI can be traced a century ago. Godley and Fletcher (FLETCHER, 2000) discovered FDI activities in British sailing and purchasing section dates back to 1850. However, Economists stared their study regarding theories of foreign direct investment in the 1960's. Economist always thought that FDI is good for international capital movement. In the 1960's the prevailing justification for international capital movements based on exclusively upon a neoclassical economic hypothesis of portfolio flows. In a frictionless globe of perfect competition, where no cost for transaction, capitals are working to change the interest rate differentials (SEE CARL IVERSEN (1936)).

According to this article, capital is considered as the transaction that happened between individual or independent buyers and sellers, because there is no any role for MNC (Multinational Corporation). Although there are many evidences for cross countries investments and also there exist inter industry trade with large MNC's but still no one present there who can do a question of "why we need FDI?"Hymer (HYMER, 1960) in his influential thesis moves us towards an investigation of MNC's depends on industrial organization theory. The revolutionary conceptual approach of Hymer was to break out of the arid model of international business and speculation theory and paying attention upon the MNC's. FDI have a mechanism with a unique

feature through which Multinational Corporation manage to control the activities that are productive and have influence on national boundaries.

2. METHODOLOGY

We make the utilization a capital-domestic capital-foreign straight investment-labor-international business (K, F, L, X) mock-up of economic production function and development. Capital K, Foreign Direct investment, F, Labor, L and international trade X are the producing features of production that make the industrialized output Q. First, the effects of direct investment and foreign business in different economic growth phase are poles apart. Second, the power and method of FDI in the different economic growth procedure are different.

The method we use to examine our hypothesis tries to study the relationship between direct investment, exports, and economic development in 14 countries (including 7 developed and 7 developing countries) in the perspective of new development theory. Foreign direct investment is introduced in the assembling function as an input in adding to domestic capital. Foreign direct investment has been considered as a main source of technical advancement and economic growth. Borensetein (BORENSZTEIN, EDUARDO, GREGORIO, and LEE, 1998) explains that foreign direct investment is considered to be a “crowding-in” domestic investment outcome, that is, a one-Dollar raise in the net inflow of foreign direct investment is connected with a raise in total investment in the beneficiary economy of more than one Dollar. Certainly, it is the capability of foreign direct investment to transfer not only production and

know-how, but also decision-making skills that differentiate it from all other forms of investment, including portfolio investment.

As supplementary factor input into the making function of goods in order to study different things between FDI and exporting in the different countries along with different economic growth steps also introduce in this research work. The scheme of international trade is the steam engine of growth in very old time, going reverse at least to Adam Smith. A number of experiential studies have been performed on the export-led growth testing. MICHAELY (1977) uses plain rank correlation on a 41-country taster for 1950-70 to analyze whether the rate of growth of exports has been linked with GDP, and their relationship with growth output. His consequences explain that the Spearman rank coefficient was significantly positive (0.308) for the sample as a whole. It was big (0.523), however, for a sub sample of 23 middle-income countries.

BALASSA (1978) also uses the rank correlation methodology to examine this problem. Using pooled information on 11 countries for 1960-73, his outcomes reveal once again a positive correlation coefficient between different measures of the rate of development of exports and output for growth. FEDER (1983) established a simple framework with exports segment and a non-exports segment depends on neoclassical production function, as well as the consequences explain that marginal aspect productivity in the export segment is higher than in the non-export segment. SALVATORE and HATCHER (1991) give three reasons for the explicit beginning of exports into the production function. First, they debate that export point of reference is likely to guide higher things productivity because of the development of economies of scale, improved utilization of competence and lesser capital- output ratios. Secondly, they

debate that exports are probable to alleviate serious foreign swap over constraints and can thus give greater access to international marketplace. Thirdly, exports like FDI are possible to effect in a higher rate of technological improvement and dynamic knowledge from abroad.

As argued above, our production function is written as follows:

$$Y=g(K, F, L, X) \quad (1)$$

Where, Y indicates gross domestic product (GDP), K is used for domestic capital (gross fixed capital formation), F is stock of foreign direct investment, L is for labor force, and X is export.

For the cleanness, we suppose that the production function g in (1) is a log linear function. We have the following expression describing the determinants of the development rate of GDP:

$$Y = \square\square + \square*K + \square*F + \square*X + \square*L + \square \quad (2)$$

3. RESULTS and DISCUSSION

The information used in this research study is from global Financial Statistics 2001, 1980, 1965, Equilibrium of fee Statistics Yearbook 1996, and the World Bank display CD-ROM 2001 and IMF CD-ROM 2001. The example used for investigation consists of 15 countries. These countries can be divided into 2 sets: one is economy of developing countries and the other is economy of developed countries. The sample section covers up the years from 1970 to 2001.

Before we continue to discuss our production method for analysis, we would like to make use of Figure 1 and Figure 2 to explain a difference of international trade between the developed and developing countries above the sample phase. Figure 1 shows the Foreign Trade Dependence Degree (FTDD thereafter) described as the ratio of total trade (For both exports and imports) to GDP for 5 developed countries (United States, United Kingdom, Germany, Japan, and France). It evaluates the degree of a nation's economic based on its foreign business.

In Figure 1 we make plot for FTD in these 5 developed countries over the sample phase. Foreign trade based degree moved up throughout the period of 1960's and 1970's in the developed countries like United States, Japan, United Kingdom, Germany and France, which reveals a strong drag force to the economic development by the foreign business. Since the mid 1980's foreign trade based degree increase their tendency, and in Japan and Germany this figure has even go down.

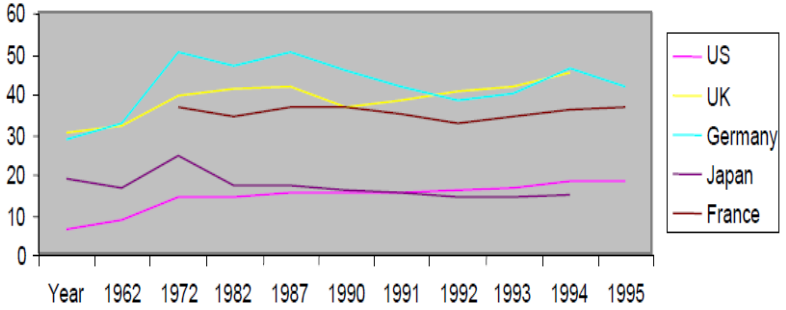

Figure 1: Foreign Trade Dependence Degree
Foreign Trade Dependence is describes as the ratio of whole trade to GDP
Information source: IMF: International Financial Statistics 1999, Equilibrium of Payment

Figure 2 and Figure 3 shows the trends of Foreign Capital Dependence Degree (FCDD) and Foreign Direct Investment Dependence Degree (FDID subsequently) for the 5 developed countries. The foreign capital reliance degree is the ratio of its financial and capital's inflows including outflows (which s foreign direct investment; stocks, bonds and securities savings; trade recognition, advance, deposits, and other savings on long or short tenure) to GDP ((total capital flows)/GDP). FDID is described as the ratio of a nation's FDI for both inflows and outflows to GDP (TFDI)/GDP), which illustrates the inter-relation between the global investment and a country's economic development. These ratios are used to shows a nation's production internationalization degree and how greatly a country depends on international transaction in developing its economy.

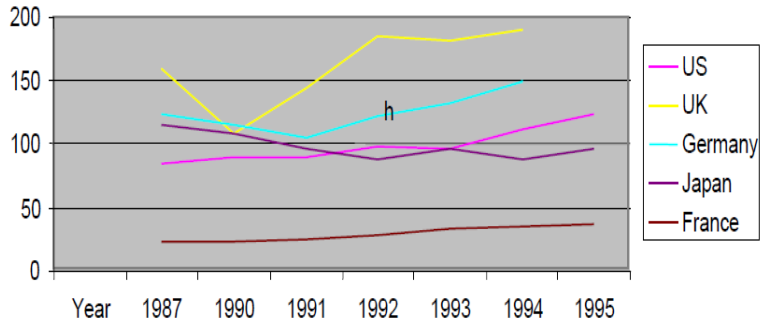

Figure 2: FDI Foreign Capital Dependence Degree is describes as the ratio of total capital for both
Inflows and Outflows to GDP
Information source: IMF: International Financial Statistics 1999, Balance of Payment

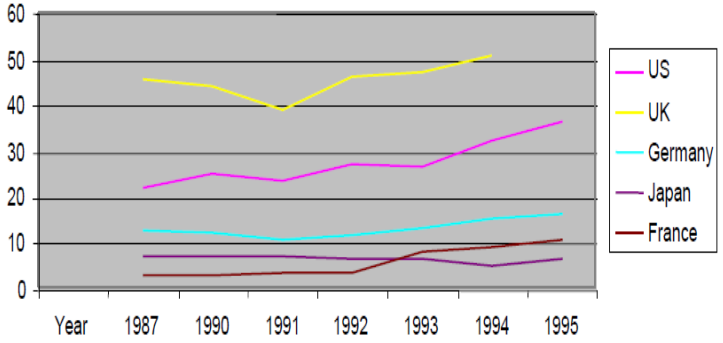

Figure 3: FDI Based Degree
Foreign Trade Dependence Degree is described as the ratio of total FDI to GDP
Information source: IMF: International Financial Statistics 1999, Balance of Payment

After inflowing into the 1980s, particularly in the 1990s, with foreign trade based degree displays slow trends, the foreign investment dependent and FDI dependent came into a quick growth procedure in these countries. In a period of 5-year from 1991 to 1995, there had been an 80.36% and 4.95% increase in United Kingdom, 39.7% and 14.4% in United States, 24.94% and 4.95% in Germany (see Table 2). Only Japan had practiced a decrease for the both ratios over the similar period. These statistics illustrates that the foreign investment dependent measure is much superior to the foreign trade dependent measure, indicating that in these countries the internationalization degree of monetary resources is much greater than that of the products.

Table 1 displays the regression test for growth rate of real GDP on domestic transactions, FDI, work force, and exports using data of at least 14-country. 12 out of 14 countries had positive coefficients of

Foreign Direct Investment, indicating that the overpowering many countries to show the drag force of FDI in their economic development.

From Table 1, we examine that the coefficient of Foreign Direct Investment is positive and t-statistics is important at 1% level for China. This end result displays that Foreign Direct Investment improves the productivity of investment in China. This judgment is reliable with our previous conversation on Foreign Direct Investment in the developed countries. Ever since the improvement and opening in 1978, Chain foreign trade dependence degree raised quickly from 9.79% in 1978 to 40.3% in 1995. This specifies that the foreign trades have dragging function in the nation's economic development during this period. The knowledge of the developed countries demonstrates that, when the foreign trade dependence degree cultivates to a certain level, it will go into an established.

Table 1: Regression Analysis of Determinations of Growth Rate of Real GDP (1970-1999)

Country	α	□□	□	□□	□	R-squared
Australia t-Statistic	20.28932 0.714607	0.256748 0.924336	1.254576 1.555205	0.265336 0.34064	-0.047284 -1.014629	0.477712
Brazil t-Statistic	0.240797 0.016395	0.604671 1.481575	0.174289 0.1489	0.255572 0.599447	-0.002134 -0.847393	0.225448
Canada t-Statistic	-9.669696 - 0.76007	0.427427 1.317503	-0.783818 -1.607508	0.235109 1.55049	-0.000617 -0.09617	0.238985
China t-Statistic	-22.41192 -2.6741717	1.296082 8.753355	4.49863 3.217632**	-0.566331 -	-0.000135 -	0.870238

				2.910839	0.881693	
France t-Statistic	-18.38919 -0.964015	0.439741 2.020546	0.020897 0.116794	0.060926 0.250614	0.003907 0.557817	0.26279
India t-Statistic	4.991848 0.457997	0.165237 0.343633	1.694427 0.088804	2.610582 1.338955	- 0.000758 1.263888	0.398563
Indonesia t-Statistic	-15.48544 -0.830552	1.457836 2.919421	7.814265 0.978785	0.119383 0.593986	0.003507 1.708677	0.459176
Italy t-Statistic	21.936 0.459214	-0.337105 -0.629096	-2.591324 -1.203114	- 0.100811 - 0.487004	- 0.003119 - 0.201491	0.125967
Japan t-Statistic	10.0896 0.503718	0.167405 0.572934	0.805338 0.942142	- 0.175231 - 0.684413	- 0.001578 - 0.896492	0.254509
Malaysia t-Statistic	2.236046 0.575119	0.220775 1.155174	1.36097 1.376661	- 0.005512 -0.04642	- 0.007555 - 0.421746	0.442827
Mexico t-Statistic	-15.23204 -1.790312	1.011426 2.850761	2.991305 0.999005	- 0.216487 - 1.170506	-0.00095 - 0.732848	0.508198
Thailand t-Statistic	1.624437 0.3321194	0.612056 5.147151	0.678899 0.225231	- 0.098565 - 0.457737	- 0.003993 -1.0205	0.729093
UK t-Statistic	0.066632 0.002052	0.768341 3.45171	0.122107 0.972867	0.726764 3.854319	-0.01067 - 0.946172	0.826077
USA t-Statistic	-24.18011 -2.358699	0.874554 3.13743	-0.305523 -0.339995	- 0.546865 - 1.253237	0.001337 1.978124	0.417592
Total Sample t-Statistic	–0.53 –1.24	0.173 -9.619	0.005 -0.201	0.001 -1.636		0.064

y=□+□□k+□□f+□□l+□□x

Y indicates gross domestic product (GDP), K is for showing the domestic capital, F is used foreign direct investment, L is present here as work force, X is exports.

**-- significant at 1% level

Information Source: World Bank displays CD-ROM 2001 and IMF CD-ROM 2001

4. CONCLUSION

This complete research work covers foreign direct investment (FDI) in the context of an open macroeconomic stability, focusing China. By using the information from 14 countries (7 developed and 7 developing countries) and manufacturing functions that depend on domestic transactions, FDI, work force, export, we study how foreign direct investment plays a role in sustainable economic development in the developed and developing economy relative to the involvement of foreign trade to economic development. The country-specific time cycle statistics and cross-country panel statistics are analyzed to determine the impact of developed countries on economic growth.

The consequences of this research work show that foreign direct investment is an important element of open macroeconomic growth and an important variable of open economy. This research finds that 1) Foreign direct investment becomes energy and force in economic development, especially in the later phases of industrialization; and 2) Foreign direct investment is a balancing variable in an open macroeconomic stability. Particularly, this research article finds that a country's foreign trade is the steam engine in the starting period of the economic growth, while foreign direct investment is the main engine in the post-industrialization phases.

From the hypothesis and technical literature which were analyzed and consulted, a positive relation is recommended between foreign direct investment and economic development. Numerous figures and data that were obtained for this research support this suggestion, but also show that the stage which is researched shows differences with information and figures that have been calculated in earlier literature. From the beginning of the monetary crisis change has set in and the relation between foreign direct investment and economic development starts to show less intensity in relationship with what is suggested by the scientific literature.

The main design of this research work was to observe the impact of FDI and Exports on Economic development of China. We are going ahead with the trends of foreign direct investment, Exports and Growth, the past overview of China.

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