

Significant review of literature and value orientation on the relationship between foreign direct investment and economic growth

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Abstract: The relationship between FDI and economic growth has been extensively debated in the economic literature over the past few decades. There are divergent findings on this relationship in theories and extant material. On the one hand, some academics contend that foreign direct investment (FDI) could spur technological progress through the adoption of foreign technology, know-how, and technological spillovers, so bolstering host nation economies. Over the past two decades, foreign direct investment (FDI) flows have increased as a result of the globalization of national economies. The potential gains for the FDI receiving countries as a result of this increase in FDI flows has sparked study on the relationship between FDI and economic growth. In this vein, the current research attempts to conduct a thorough analysis of the existing literature, variable by variable, with a specific focus on the relationship between FDI expansion and developing economies. Additionally, a particular focus has been placed on reviewing some studies that have already been done on identifying the factors that influence FDI and researching the relationship between FDI and growth in the BRICS group of nations, which are regarded as the most rapidly developing and representative developing economies in the world right now due to a spectacular increase in FDI flows. The literature that is currently available can be summarized to show that the FDI-growth relationship is far from definitive. The thorough analysis carried out in this study uncovers conflicting evidence on the growth performance of FDI, which is determined to depend on the characteristics of the host country, such as trade openness, macroeconomic stability, financial development, and economic freedom.

Keywords: FDI and economic growth, foreign technology, financial development, economic freedom

Introduction:

There is a common framework definition of foreign direct investment in the literature (FDI). In other words, a foreign direct investment is an investment intended to obtain a long-term management stake (often 10% of the voting stock) in a company that operates outside of the investor's place of residence (World Bank, 1996). FDI can be categorized into two types: merger and acquisition (M&A), which involves the acquisition of existing stake rather than fresh investment, and "greenfield" investment, sometimes known as "mortar and brick" investment. When at least 10% of the voting stock or common shares are owned, a direct investment relationship is established in terms of corporate governance. Less than 10% ownership is recognised as a portfolio investment. Reinvesting profits, taking out loans and other forms of comparable capital transfer between parent firms and their subsidiaries also fall under the category of foreign direct investment, in addition to Greenfield investments and M&A. A nation may both host FDI projects within its borders and take part in FDI initiatives in other nations. The projects that a nation hosts for FDI make up its inward FDI position, whilst projects held by foreign investors make up its outward FDI position. The phenomenal increase in FDI by multinational firms over the past few years, which has replaced other forms of foreign financing as the principal source for nations all over the world, is a significant feature of globalization. For developing nations and less developed nations, the importance of foreign direct investment (FDI) has increased over the past few years. In fact, it rose quickly in the 1990s and late 1980s. The UNCTAD database shows that between 1991 and 2000, FDI stocks increased by five times while FDI flows to less developed countries increased by seven times. Foreign direct investment (FDI) is defined as an investment that reflects a long-term stake and level of control held in an enterprise by a foreign direct investor who resides in one economy (UNCTAD, 2018). Foreign direct investment has a significant impact on how economically integrated countries are becoming. The quantitative method was traditionally utilised in FDI promotion programmes, and countries' top priorities tended to be maximizing FDI inflows. Yet, the development of information and communication technology (ICT) tools has given multinational corporations access to more accurate and comprehensive information, enabling them to make investment decisions about which countries to invest in. FDI is increasingly seen as a driving force behind economic expansion and development in both industrialised and developing nations. Huge efforts have been

undertaken across nations to encourage inbound FDI flows by providing various incentives to international investors due to the widely held notion that FDI has the potential to effect economic growth. With these efforts made by nations all over the world, FDI flows have dramatically increased over the past few decades. Hence, FDI has attracted a lot of interest globally. It has become a crucial area of interest for academics, professionals, and decision-makers. Several scholars have concentrated on the connection between FDI and economic growth using various nations as their sample. Yet, inconsistent empirical data have been discovered in the literature. While some studies claim that FDI stimulates economic growth, others show the exact opposite. To analyse the effect of FDI on the economic growth of the recipient economies, a variable-wise evaluation of the literature has been done for this research. This review tries to identify and investigate those variables that have an impact on the FDI-growth nexus because the growth impact of FDI appears to be dependent on some other variables. Also, the BRICS nations with the fastest expanding economies have received special attention because they have excelled at luring international direct investment.

Review of Literature:

The connection between FDI and economic growth has become incredibly important in the literature on growth. Regarding the relationship between FDI and growth, the available literature provides conflicting evidence. The third strand of literature includes mixed results within the individual studies, and the fourth group of studies reveals that FDI does not exert an independent influence on economic growth. While some studies show a positive growth impact of FDI in the host countries, others yield statistically insignificant, negative, or no contribution of FDI towards economic growth. In order to acquire a better and deeper understanding of the growth impact of FDI in the host economies, we offer all four strands of literature in the section that follows. The review is organized in a logical order, starting with research that show FDI has a positive growth impact, followed by studies that show a negative, insignificant, or no impact, and finally the third and fourth strands of literature.

In their 2012 study, "Effect of Foreign Direct Investment and Merchandise and Services Trade on the Economic growth in India: an Empirical study," Bhattacharyya Jita and Bhattacharyya Mousumi found a long-term connection between FDI, goods, and service trade and India's economic growth. There is evidence of a two-way causal relationship between trade in goods and services and economic growth. There is a one-way causal relationship between FDI and trade in goods as well as FDI and economic growth. Moreover, a one-way causal relationship between trade in goods and trade in services is seen.

Do overseas acquisitions by emerging-economy enterprises increase shareholder value? Gubbi S. R., Aulak P. S., Ray S., Sarkar M. B., and Chittoor R. (2010). In the instance of Indian enterprises, it was discovered that international acquisitions made it easier for firms in emerging economies to internalize both tangible and intangible resources that are hard to exchange through market transactions and require time to develop. Our projections are supported by an event study of 425 international acquisitions made by Indian companies between 2000 and 2007.

Singh J. (2010), "Economic Reforms and Foreign Direct Investment in India: Policy, Trends and Patterns," in the context of increasing competition among nations and subnational entities to attract Foreign Direct Investment (FDI). The current paper attempts to analyze the emerging trends and patterns of FDI inflows into India in response to various policy measures announced by the Government of India since mid-1980 and later. The empirical study tends to imply that the overall pattern of FDI inflows throughout the post-reform period is one of growth. Also, a comparison of FDI inflow by nation shows that, in contrast to other developing countries, FDI influx to India has significantly expanded in recent years. As a result, the study shows that the liberalization policies put in place in the early 1990s had a favorable impact on FDI inflows into India.

The Effect of FDI and Financial Sector Development on Economic Growth: Empirical Evidence from Asia and Oceania, Chee Y. L. and Nair M. (2010) "The results of the empirical investigation demonstrated that the expansion of the financial sector increases the impact of FDI on regional economic growth. It also demonstrated that the least developed economies in the region are most in need of the complimentary effects of FDI and finance sector development on economic growth. The study also discusses important measures to strengthen the impact of FDI and financial development on economic growth in developing and least developed Asia and Oceania countries.

According to a research by John W. (2010) titled "China's FDI and non-FDI economies and the sustainability of future high Chinese development," foreign invested enterprises (FIEs) are responsible for over 50% of China's exports and 60% of its imports. While their average labor productivity is about nine times greater than that of Non-FIEs, they only employ 3% of the labor force in China, despite contributing more than 20% of the country's GDP during the past two years. Due to FIEs' access to international distribution networks and product design for export markets, their manufacturing is geared more toward export than the domestic

market. Without this inbound FDI, China's overall GDP growth rate may have been about 3.4 percentage points lower. China's FIEs may have contributed more than 40% of China's economic growth between 2003 and 2004.

Foreign Direct Investment and Economic Growth:

Numerous empirical analyses of the FDI-growth relationship that have used various samples and estimation techniques have found a positive correlation between the two variables. Using a Vector Autoregressive (VAR) model, Hansen and Rand (2006) investigated the relationship between FDI and economic growth in 31 developing nations in Asia, Africa, and Latin America. The results of the study's mean group estimator and fixed effects estimator show that FDI has a long-term effect on GDP growth. It was discovered that there are no systematic differences in the overall impact of FDI across regions while addressing the issue of heterogeneity, indicating that the growth benefits from FDI to Africa should be equal to the growth-enhancing impact of FDI in Latin America and Asia. Yao (2006) used a dynamic panel data approach to examine the effects of FDI and exports on economic growth for 28 Chinese provinces between 1978 and 2000. The results show that both FDI and exports have a significant positive impact on economic growth. The study recommends that developing nations adopt two important development strategies that China has successfully implemented. Adoption of international technology and business practices, and export promotion policies. Further study in this area was motivated by discussions among economists around the world regarding FDI's potential to boost economic growth. Exports can be used to boost growth in the early stages, according to Tiwari and Mutascu (2011), whereas FDI should be used to boost growth in the later stages. The degree of complementarity and substitution between foreign direct investment and domestic investment determines how much FDI is generated. FDI was found in other studies to have a favorable impact on economic growth (Bouchoucha & Ali, 2019; Pegkas, 2015 and K. H. Zhang, 2001). The relationship between FDI and GDP per capita in the Singaporean economy was evaluated by Feridun & Sissoko in 2011. The study's main conclusion is that FDI, which implies a one-way causality from FDI to GDP, is what drives economic growth in Singapore. However, there is no proof that FDI and GDP are causally related in both directions. A cointegration analysis by Dritsaki et al. (2004) revealed a long-term connection between FDI, exports, and economic growth in Greece. According to Metwally (2004), there is a feedback effect in which an increase in FDI inflows causes an increase in exports, which then increases the Gross National Product (GNP), which in turn draws in more FDI. In India, FDI, exports, and GDP have a long-term relationship, according to Sahoo & Mathiyazhagan's 2003 research. Both exports and foreign direct investment (FDI) contribute to economic growth, but exports are more effective than FDI at doing so. Additionally, Szkorupová (2014) discovered a long-term connection between exports, FDI, and economic growth in Slovakia. The economic growth of the nation is positively impacted by both FDI and exports. A different team of researchers discovered a contradictory, statistically insignificant, or no relationship between FDI and the host economies' economic growth. Mencinger (2003), for instance, discovered a negative causal relationship. Since the sales revenue was primarily used for consumption and imports rather than increasing the productivity of local assets, the chosen form of FDI, acquisition is to blame for the negative correlation between FDI and economic growth during the reference period. A significant correlation between current account and FDI was also discovered; as FDI flows into a country rise, so do its current account deficit and foreign debt. Herzer (2012) also disproves a number of earlier studies, as his study's findings unmistakably show that FDI generally has a negative effect on economic growth in developing nations. Using time-series data, Lian & Ma (2013) investigated the relationship between FDI and economic growth in China's western region. The findings indicate that FDI inflows do not result in economic growth in the recipient economies and that economic growth also has little to no influence on FDI, suggesting that some people have exaggerated the effects of FDI. The paper offers some policy recommendations that urge the host countries to improve the quality of FDI utilization in addition to attracting more and more FDI flows in order to better support economic growth. The Generalized Method of Moments (GMM) technique was used to examine the effect of FDI on per capita growth in Russia (Ledyeva & Linden, 2006). The findings imply that FDI did not significantly contribute to economic growth, and that domestic investment, exports, and the early stage of economic development during the reference period account for the majority of the growth. In spite of the fact that Spain is a large recipient of FDI and has the necessary good absorptive capacity to benefit from FDI's growth-enhancing effects, Carbonell & Werner (2018) found no significant positive impact of FDI on economic growth in Spain. They did this by using an improved and reliable empirical methodology called the General-to-specific (GETS) method. In order to determine whether the effect of FDI on growth has been overemphasized in the literature, Gunby, Jin, and Reed (2017) carried out a meta-analysis. The study's key finding is that FDI has a much smaller impact on Chinese economic growth than was anticipated. A publication bias or the characteristics of the sample may be the cause of the tendency to overemphasize earlier estimates. Research is conducted in the six Gulf Cooperation Council nations (Kuwait, Oman, Qatar, the Kingdom of Saudi Arabia, the United Arab Emirates, and Bahrain) has been researching the effects of FDI on growth for the years 1996 to 2007 (Hussein, 2009). According to the

findings, there is little correlation between FDI and GDP in these nations. Awolusi et al. (2017) find that FDI has a negligible positive effect on economic growth in a few African economies. A bidirectional causality between FDI and economic growth in China is not very significant, according to Zhao & Du's 2007 research; however, there is a unidirectional causality that runs from economic growth to FDI. Christopher (2012) found a correlation between FDI and economic growth, but for the time period under consideration, FDI's contribution to GDP growth was very low. Regarding the effect of FDI on the economic growth of recipient countries, the third body of literature produces conflicting findings. According to Lo et al. (2016), FDI had a positive impact on the development of the Chinese economy through an increase in allocative efficiency, while a negative impact was discovered through a decline in productive efficiency, which resulted in a net negative impact because the decline in productive efficiency outweighed the gains in allocative efficiency. According to Alfaro (2003), the effect of overall FDI on growth is unclear. In the primary sector, FDI has a negative effect on growth; in the manufacturing sector, it has a positive impact; and in the service sector, there is ambiguous evidence. FDI approvals and actual flows were separated by Dua & Rashid (1998) in order to examine the effects of both on the level of economic activity in India as measured by industrial output. The Granger Causality test results show that industrial output affects both FDI approvals and actual flows, whereas actual FDI flows have no effect on industrial output and only FDI approvals do. According to Akpan and Eweke (2017), there is no consistent correlation between FDI, industrial sector output, and GDP in Nigeria over the long term. However, it is discovered that there is a bidirectional relationship between FDI and Industrial Sector Output, GDP and Industrial Sector Output, as well as a one-way causality that runs from FDI to GDP. Zhang (2001) examined the relationship between FDI and economic growth and found that East Asia tends to benefit more from FDI than Latin America. Johnson (2006) discovered that FDI inflows only benefit developing countries' economic growth, not that of developed nations. For Turkey and Pakistan, FDI and GDP are discovered to be co-integrated, according to Ozturk & Kalyoncu's 2007 research. In the case of Pakistan, the findings show a unidirectional causality from GDP to FDI, whereas in the case of Turkey, the findings show a strong bidirectional causal nexus between FDI and GDP. In India, Durairaj (2010) discovered a long-term connection between exports, economic expansion, and FDI. Short-term research shows a bidirectional causal relationship between exports and economic growth and a unidirectional relationship between exports and FDI. In Malaysia and Thailand, Chowdhury & Mavrotas (2006) find a bi-directional causal relationship between GDP and FDI, but in Chile, only a unidirectional causality is found to run from GDP to FDI and not the other way around. An analysis of the causal relationship between foreign direct investment (FDI) and economic growth in Ghana for the pre- and post-SAP (Structural Adjustment Programme) periods was done by Frimpong & Oteng-abayie (2006). The results showed that there was no causal relationship between FDI and growth for both the pre-SAP period and the entire reference period. However, FDI led to economic growth in Ghana during the post-SAP era, when the country experienced a relatively stable political and economic environment. In a group of 80 countries, Choe's 2003 study identified a bidirectional causal relationship between FDI and economic growth; however, the impact is stronger from FDI to growth rather than the other way around. The results of the fourth set of studies show that FDI has an indirect impact on economic growth due to other factors present in the host environment. According to Carkovic and Levine's findings from 2002, FDI inflows do not independently affect the economic development of a host nation. The results do not support the idea that FDI has a positive impact on growth that is independent of other growth determinants, even though sound economic policies may promote both growth and FDI. In the case of China, Cao & Jariyapan (2012) discovered similar results. The results of the study, which looked into the potential growth channels for FDI, suggested that the impact of FDI on economic growth depends on the level of human capital that is present in the host country (Borensztein et al., 1998). Other researchers have discovered that the level of human capital in the host economy affects how much FDI will boost growth (Balasubramanyam & Mahambare, 2003; Li & Liu, 2005; Iqbal & Mumit, 2017; Wang & Wong, 2009; Bende-Nabende et al., 2001; Jyun-Yi & Chih-Chiang, 2008). The sections that follow provide in-depth literature on some of the major factors influencing the growth of foreign direct investment, such as trade openness, macroeconomic stability, financial development, and economic freedom.

Foreign Direct Investment, Trade Openness and Economic Growth:

The relationship between a country's economic performance and its trade policies has been the subject of extensive debate in the literature. Liberal economists contend that nations with free trade agreements grow their economies more quickly, while others hold that protectionist trends, not free trade agreements, are what spur economic expansion. The theory behind the trade-growth nexus is that specialization and labor division occur as a result of trade openness. More open economies are associated with faster economic growth, according to some studies' empirical findings (Harrison, 1996; Greenaway et al.; Edwards, 1998). The growth-enhancing effects of FDI are dependent on the characteristics of the host economy, with trade openness being one of the most significant of these characteristics. According to Nair-Reichert & Weinhold (2001), there is evidence that the

potential for FDI to boost future growth rates is higher in more open economies. However, the relationship between domestic and foreign investment and economic growth is highly heterogeneous in developing countries. According to Nunnenkamp & Spatz's 2003 research, FDI and economic growth in developing nations are positively correlated. However, the characteristics of the host nation, such as GDP per capita, educational attainment, institutional growth, and trade openness, have an impact on this relationship. Using Bayesian Model Averaging (BMA), Tondl (2008) examined the relationship between FDI and growth in Latin American (LA) countries and discovered that, subject to macroeconomic stability and a well-developed legal system, FDI has a strong correlation with productivity growth in LA. In other country contexts, trade openness, human capital, or income threshold are significant channels to benefit from FDI's positive productivity effects. By examining the manufacturing affiliates of US multinational corporations from over 44 countries, Athukorala & Chand (2000) investigated the impact of trade orientation of FDI receiving countries on the productivity gains from international production of foreign affiliates. A more open trade policy regime is found to have higher production levels. Foreign direct investment and trade openness have a significant positive impact on economic growth, whereas inflation has a negative impact, according to Cinar & Nulambeh's (2018) study of the relationship between FDI, inflation, and economic growth in Sub-Saharan African countries. The article urges institutions responsible for formulating policy to develop plans aimed increasing FDI in Africa. In a panel of 23 developing countries, Basu et al. (2003) examined the causal relationship between FDI and economic growth and discovered that in more open economies, there is a bidirectional causality between FDI and economic growth, whereas in closed economies, there is a unidirectional causality running from GDP to FDI. Under an open trade policy regime, they strengthen one another. According to Wijeweera et al. (2010), FDI inflows have a positive effect on economic growth when there is a skilled labor force. While trade openness has a positive impact on economic growth through efficiency gains, corruption has a negative impact on it. When data on domestic investments are taken into account, the results show strong economic growth in the seven countries of southeast Europe. Additionally, it is discovered that the primary drivers of growth in these nations are macroeconomic stability and trade openness.

Foreign Direct Investment, Macroeconomic Stability and Economic Growth:

There is compelling evidence in the literature that demonstrates how important financial development is to a nation's economic success. Effective financial systems are thought to result in an improvement in rates of economic growth as a result of improved capital allocation and lower transaction costs. According to Beck et al. (2000) and King & Levine (1993a, 1993b), financial systems that are established well promote economic growth and development. Many experts contend that in order for foreign enterprises to successfully acquire new technology, they frequently need to obtain outside funding, which is only achievable if the host country has a well-developed and in place an effective financial system. According to Alfaro and Charlton (2007), there is a correlation between FDI at the industry level and better growth. This correlation is larger for industries with higher skill needs and greater reliance on outside financing. The policy makers are advised to increase the level of financial market development in order to benefit from the spillovers produced by FDI, as evidenced by the empirical studies that demonstrate the significant role financial markets play in assisting host countries to realize the benefits of FDI (Alfaro et al., 2004; Alfaro et al., 2005). Kelly (2016) discovered that only nations with a sufficiently developed financial sector have a long-term association between FDI and economic growth. According to Hermes & Lensink (2003), FDI has a beneficial impact on growth in nations with sufficiently advanced financial systems. Alpha & Chauvin (2016) discovered that the financial developed economies, which enable domestic enterprises to significantly benefit from the opportunities, provided by foreign firms, experience greater FDI spillover advantages. Durham (2004) found that the growth-enhancing effects of FDI and EFPI (equity foreign portfolio investment) depend on the financial and institutional development of the host countries rather than supporting a direct, independent beneficial impact of FDI and EFPI on growth. The substantial impact that the financial sector played was shown by Chee & Nair (2010). Compared to developing and developed nations, the impact of sector development on growth is more pronounced for least developed nations. According to Prasad et al. (2007), countries that depend on foreign investment grow. After a rigorous review of 880 estimates provided in 108 articles, a metaregression analysis (MRA) was used to determine the link between FDI and growth. The host economy's level of financial development and trade openness are two factors that can allow FDI to have a beneficial impact on growth (Iamsiraroj & (2015) Ulubaolu). According to Azman-Saini et al. (2010), FDI only has a growth-enhancing influence on the host economy. According to Lee and Chang (2009), FDI, financial development, and economic growth are positively correlated over the long term but negatively correlated in the short run. Anwar and Nguyen (2010) found a two-way relationship between FDI and Vietnamese economic growth. Yet, FDI tends to have a bigger growth impact when resources are invested. Ljungwall & Li (2007) found that the growth of the financial sector in the host nation improves the effects of foreign direct investment on growth. In the Economic Community of West African States, Adeniyi

& Omisakin (2012) investigated the relationship between foreign direct investment and economic growth by examining the effects of banking sector development on the FDI growth nexus (ECOWAS). The results validate the financial sector's function. Yet, regardless of the level of development of the financial sector, there is no direct relationship between FDI and economic growth in Nigeria. According to Kholdy and Sohrabian's (2005) research, FDI stimulates economic growth even in nations with advanced financial systems.

Foreign Direct Investment, Economic Freedom and Economic Growth:

It is thought that a well-developed institutional structure that encourages investment will provide a favorable environment for foreign investment. The domestic investment climate is defined by excellent governance, a supportive environment for markets, property protection, and an adequate degree of freedom to operate in a country becomes a top draw for international investors. A supportive environment like this tends to make it easier for foreign investors to overcome business obstacles, which helps them more effectively. A composite indicator, or the degree of economic freedom present in a nation, is used to describe the domestic investment climate of an economy. Economic freedom, according to the Heritage Foundation's suggested index, consists with property rights, freedom from corruption, tax burden, government expenditure, business freedom, labor freedom, financial freedom, trade freedom, investment freedom, and freedom from money are the 10 components. A nation with a free economy offers advantageous conditions for international investors. Economic freedom was found to be a significant factor in attracting inbound FDI in South Asia (as measured by the FDI index) and foreign direct investment. Economic freedom was also discovered by Quazi (2007) to be a favorable and substantial driver of FDI in Eastern Asian nations. Researchers are motivated to find additional factors that can strengthen the growth impact of FDI because it is thought that FDI has an impact on the host economy's economic growth. According to Zghidi, Sghaier, and Abida (2016) that the inclusion of the economic freedom variable makes the growth-enhancing effect of FDI more obvious. According to Burcu (2019) and Azman-Saini, Law, and Ahmad (2010), FDI does not have a separate impact on economic growth. Additionally, some research discovered a significant and favorable relationship between foreign direct investment and economic freedom to influence developing nations' economic progress (Sheshgelani & Badri, 2017; Hayrdaroglu, 2016).

Conclusion:

Globally, foreign direct investment is regarded as the answer to every country's economic woes. This has spurred researchers to investigate how FDI and growth interact in host nations. Based on the study of the literature review done for this paper, it can be concluded that there is conflicting evidence in empirical studies looking at how FDI affects the host country's economic growth. Furthermore, it has been observed that the growth performance of FDI varies across different countries based on factors such as the host country's trade openness, macroeconomic stability, financial development, and economic freedom. In order to reap the rewards of foreign direct investment, countries should create an effective policy framework aimed at improving the current absorptive capacity in concert with the inward FDI flows. Host nations should implement reforms targeted at improved resource distribution, streamlining complicated regulatory processes for firms, enhancing the political and economic environment for greater FDI attraction, and diversifying the economy to lessen reliance on primary exports. Over the past two decades, FDI inflows to developing economies have grown significantly, and the BRICS economies have contributed significantly to the paradigm change in global investment. A few researches on the relationship between FDI and growth in these economies have found a favorable correlation between the two factors. As only a few studies have been done in this area, it is important to emphasize that the growth trajectory of the BRICS economies and their increasing share in global FDI flows make it interesting for future researchers in this field to study the various dimensions of growth performance of FDI in these fastest emerging economies.

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