

Beyond Capital Inflows: Foreign Direct Investment and Economic Development in the Global Economy

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Abstract

The foreign direct investment (FDI) has turned out to be a significant source of economic modification in the globalizing economy. FDI can also serve as a source of capital for the developing and emerging economies and will also lead to changes in technology, employment, productivity and institutions. This paper explores the complex FDI-Economic Development relationship, and the long-term growth implications of foreign investments in various economic settings.

The study provides a comprehensive review of the theoretical and empirical studies that have been done to evaluate the mechanism by which FDI can aid in the economic development. Special attention is directed towards knowledge transfer, information spreading and dissemination, human capital development, infrastructure development and integration into global value chains. The analysis also delves into the factors behind the success of FDI such as governance, legal regulations, macroeconomic stability, educational system and absorptive capacities of the domestic market. There are indications that countries with a supportive institutional environment and an effective policy framework are more likely to reap the developmental gains from foreign investments.

The paper also examines some of the fresh challenges that have emerged due to FDI in the region such as regional disparities, environmental concerns and market concentration and dependence on the multinational companies. It also reflects on the changing character of investment flows in the digital economy, where more and more investments are in technology and sustainability. This result indicates that FDI can be an effective instrument of economic development if it is coupled with proper policy and development strategic planning in the country. FDI is not only a source of funds, it can also help to structurally transform the country and to enhance its competitiveness. Only a foreign investment accompanied by a balanced and inclusive investment governance framework can lead to sustainable and equity-oriented foreign investment for sustainable economic development in the global economy, the study concludes.

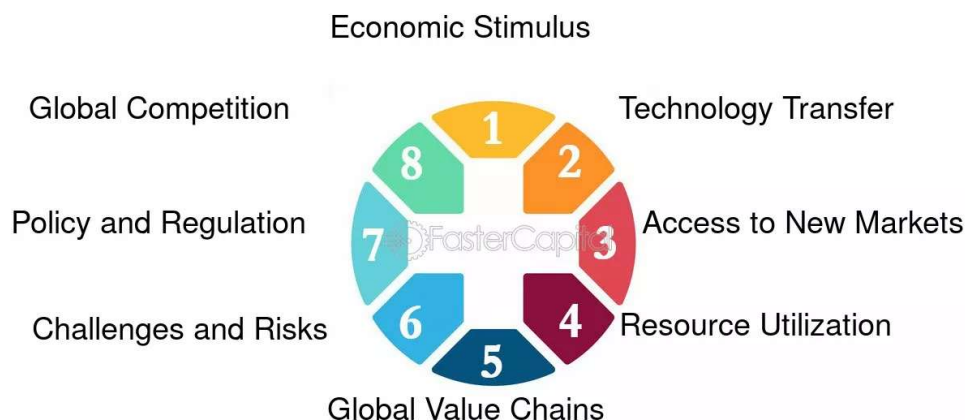
Keywords: Foreign Direct Investment (FDI), Economic Development, Capital Inflows, Technology Transfer, Human Capital Development, Global Value Chains, Sustainable Growth, Multinational Enterprises, Institutional Quality, Economic Transformation.

Introduction

The world economy has been transformed due to the growing interdependence of national economies through trade, investment, technology and information. Among the different channels of international economic relations Foreign Direct Investment (FDI) is one of the most effective tools to economic development. The traditional view on FDI has been that it is a source of capital to be used for productive investment which can complement domestic savings. But the role of foreign direct investment is more than just in capital formation. Foreign investments are an excellent means of transferring technology, management know-how, organizational processes and innovation capability as well as access to foreign markets in an increasingly integrated world.

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The Role of Foreign Direct Investment (FDI)



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Governments in developed and developing countries have undertaken policies to promote foreign investment with great seriousness in the past few decades. The process of liberalisation policies, investment friendly policies and trading agreements have created a stage to make multinationals expand their business beyond the borders. This has led to a greater relevance of Foreign Direct Investment (FDI) in the functioning of the economy, the competitiveness of industries and the structural change. Foreign investment that is productive can lead to increase in productive output, employment, creation of infrastructure and export opportunity in countries if it is attracted successfully.

The developmental effects of FDI do not necessarily occur in the same manner in all countries, however. The absorptive capacity of the host country, the standards of governance, technological readiness, human resources and institutional development are among the factors that affect the role of foreign investment in economic development. The former countries had observed FDI as a facilitator of industrialisation and technological development while the latter countries had observed FDI as a cause of regional imbalances, repatriation of profit and environmental problem (i.e. market concentration). The divergent results have spurred a great deal of discussion on the true impact of FDI on sustainable and inclusive economic development.

Foreign investment too is transforming in the modern world economy. The objectives and impacts of cross-border capital flows are evolving towards a digital transformation, global value chains, knowledge-based industries and investments for sustainability. These are usually innovation ecosystems, R&D, renewable energy and advanced manufacturing sectors that are coming up in the FDI business. Thus, an analysis of FDI in terms of capital inflows is not enough to understand the wider developmental aspects of FDI.

This research paper deals with the multidimensional relationship of Foreign Direct Investment and economic development in the world economy. It discusses the effect of FDI on productivity, employment, technology development, international competitiveness and future growth. Moreover the opportunities and challenges of foreign investments are discussed and the conditions under which foreign investments can stimulate sustainable economic development. This paper has a different perspective from the traditional one on capital accumulation, and presents an integrated picture of the effects of FDI on the economic fortunes of countries and regions.

Background of the study

Globalization has had a significant impact on international trade, investment and economic cooperation. Foreign Direct Investment (FDI) is one of the most powerful forces of economic development among the different channels which countries use to participate in the global economy. FDI is not a short-term investment, as in the case of portfolio investments, but a long-term involvement of foreign investors in the productive industries of host economies that also carries managerial skills, technology, knowledge and access to foreign markets. Consequently, the governments of both developed and developing countries have become more and more interested in policies to attract FDI for economic growth and competitiveness.

The role of FDI has increased in importance in the second half of the twentieth century when the multinational corporations began to operate in the other countries. Trade and investment policies were liberalized, communication technologies were developed and transportation infrastructure became improved, which helped the flow of capital and production activities around the world. Developing economies, particularly, saw opportunities in FDI to address the domestic limitations in resources, to promote industrialization, and to be connected with global value chains. Many countries began to take measures to encourage business, tax incentives and regulatory frameworks were introduced to create pro-business policies and environment.

Though the acceptance of the idea of the FDI contribution to economic growth is quite old, the recent studies show that this contribution is not only limited to capital inflow in the form of FDI, but also other elements are included in this. The productivity level, employment creation, human capital development, technological advancement, institutional modernization and infrastructure development are among the areas affected by foreign investment. Foreign firms may also be able to boost the capacity of domestic industries through knowledge transfer and spread of advanced production technology. Moreover, engaging in international production networks can enhance export performance and boost the overall efficiency of domestic markets.

While the effects of FDI and economic development can be positive, the relationship between FDI and economic development is not simple, and may vary from country to country and region to region. Foreign investment outcomes are influenced by institutional quality and capacity of host countries, human resources capacity, financial system development and government capacity. While in some instances, FDI has triggered industrial transformation and economic prosperity, in other instances, it has been less successful, due to weak institutional frameworks, inadequate infrastructure and lack of connections with domestic enterprises. These differences have given rise to a lot of academic debate about the circumstances in which FDI can help achieve sustainable and inclusive development.

With the rise of a knowledge based global economy the importance is increasing of FDI. The new battlegrounds for investment are technology, renewable, advanced manufacturing, finance and digital innovation. With the growing competition of the world's nations for the best investments, it is increasingly crucial to recognize the wider developmental impacts of FDI. Investment is no longer in terms of quantity, but quality, sustainability and long-term economic impact of foreign enterprises is also one of the concerns of policymakers.

If the FDI is considered as capital supply alone, then it is not sufficient in this context. Its wider economic, social, technological and institutional impacts must also be considered to be able to fully understand its role. Therefore, the current research is targeted at analyzing the multidimensional linkage between FDI and economic development in the world economy. The study will try to learn about the role of foreign investment in the current economy development, in relation to the role of FDI in structural transformation, innovation, productivity and sustainable growth.

Justification

Foreign Direct Investment (FDI) is one of the most important contributors to the economic integration and development in the present global economy. The significance of FDI on the developing and emerging economies are often linked with financial outflows; however, the impact of FDI is much wider than the financial outflows. FDI also results in technology transfer, employment generation, training of management skills, construction of infrastructure and a longer involvement in global value chains. With the growing interdependency of the economies, an awareness of the wider development (positive or negative) consequences of FDI has become vital for business managers, researchers and policymakers.

This study is justified because in the present day, FDI is no more considered merely a source of finance but it is regarded as a multidimensional tool to measure FDI impact on economic development. However, many countries compete to attract foreign capital investment, offering incentives and policy changes, and there have been region and sector differences found in the effects of FDI on development. Most of all, some countries have been able to benefit from foreign investment to industrialise, to raise their technological level, and to enhance their living standard; others have not done as well, perhaps because some of their institutions are weak, some of their policies are constrained, or because the benefit that has derived from foreign investment has not been distributed evenly.

In addition, globalization, digitalization of financial services, environmental and climatic changes and geopolitical changes have affected the structure of international investment flows. Such changes have enabled an in-depth analysis of the impact of FDI on economic development in the current world. To effectively design economic policies, it is important to grasp how foreign investment leads to productivity growth, innovation, human capital development and structural transformation.

The study also requires because of the gap between the theory and practice in the development process based on FDI. The research will be based on a general economic, social and technological approach to foreign investment to gain insights into the conditions that can ensure foreign investment becomes a catalyst for sustainable and inclusive growth. The results will help governments, international organisations and development agencies to design strategies for maximum returns and reduced risk and reliance on foreign investments.

Hence, the present study is useful as it provides an overall picture of the association between FDI and economic development, which would provide a window to stimulate the academic world and policy making in the current globalized world.

Objectives of the Study

1. To explore the impact of Foreign Direct Investment (FDI) on the economy of developed and developing economies.
2. To analyse the effect of FDI on the major economic parameters like gross domestic product (GDP), job creation, industrial production, productivity growth etc.
3. To measure the impact of FDI on technology transfer, innovation and knowledge sharing for the host countries.
4. To study the impact of FDI inbound flows on home industry and competitiveness of industries.
5. To understand the impact of FDI on infrastructure, export performance and participation in global value chains.

Literature Review

Foreign Direct Investment (FDI) is becoming an important engine of economic growth in developed and developing countries. Even though the main focus of traditional economic theories have been on FDI as a way of capital formation, modern research has focussed more on the other contributions of FDI, which include the transfer of technology and managerial skills, job creation, export promotion and institutional development.

Early research emphasized the importance of multinationals in the process of economic development as a source of accumulation of capital. Dunning (1993) argues that FDI can play a role in host-country development through the following: ownership advantages, location specific advantages and internalization. His Eclectic Paradigm gave a complete conceptual approach to the reasons behind the foreign investment and the effects of foreign investment on economic performance.

Borensztein, De Gregorio, and Lee (1998) have shown that FDI might be more effective in fostering economic growth than domestic investment in host countries with adequate human capital. They found that foreign investment can be a conduit for the transfer of advanced technologies, which in turn boost productivity and long-term growth prospects. Similarly, Balasubramanyam, Salisu and Sapsford (1996) discovered that economies that have more FDI can gain more from development than those which have more inward-oriented trade policies.

There is a considerable amount of work related to the impact of FDI on economic growth in the developing countries. Alfaro, Chanda, Kalemli-Ozcan and Sayek (2004) suggested that the impact of FDI on growth is mainly reliant on the establishment of domestic financial markets. The more efficient the financial institutions are, the more they are likely to take on foreign technologies and the more they are likely to use their resources productively. This discovery implies that complementary domestic policies are crucial to reap the maximum benefits from FDI.

Technology transfer continues to be one of the significant channels that are associated with FDI and development. Foreign firms introduce new and more advanced production processes and management techniques which local firms can acquire from foreign firms (Blomström and Kokko, 1998). These spillovers are experienced in the form of labour mobility, supplier relationships, competition and demonstration effect. But the amount of these advantages varies depending on the absorptive capacity of local companies and the strength of the national institutions.

This employment effect of FDI has also attracted the interest of researchers. Lipsey (2002) claimed that foreign enterprises can generate direct jobs, and also stimulate indirect jobs creation via local supply chain. However, certain studies have warned that foreign firms would be interested in specific sectors depending on investment, which means job opportunities in the other sectors would be curtailed. This suggests that nation and industry specific effects on development are possible from FDI.

The institutional quality is becoming an important factor of the effectiveness of FDI, as a growing number of researchers have confirmed. Globerman and Shapiro (2003) believe that good governance, clear rules and effective laws are instrumental in bringing in good foreign investments. Good institution also can help to improve the impact of investment, as it can lower transaction cost and boost business confidence, in addition to attracting inward investment.

Various researchers have studied this issue in terms of export growth and export integration in the global value chain (GVC). The study by UNCTAD (2023) pointed out that multinationals facilitate the access of developing countries to global markets and consequently to participate in global production chains. Such networking can give domestic businesses opportunities to improve their competitiveness and their quality of export products.

There is a recent trend focusing on the following dimensions of sustainable development of FDI in the literature. Foreign investment would have different developmental effects depending on the interaction between MNE and the local economic conditions, as put forth by Meyer and Sinani (2009). Innovations, environmental protection and social inclusion investments provide a positive return, which is more sustainable than the investments of resource extraction and "short-term maximization of profit".

Contrary to what has been observed in developed economies, the correlation between FDI and Growth in emerging economies has not been consistent. The fact is, however, that the evidence for a direct causal link between FDI and economic growth after taking country-specific features into account, is limited (Carkovic and Levine 2005). Their results indicate that FDI does not have a magic ability to spurt development and that it needs to be situated in larger economic and institutional frameworks. The new studies emphasize investments in digital transformation, and investments in knowledge. The World Bank (2024) notes that FDI is becoming more focused on tech-heavy sectors, digital infrastructure, and innovation and renewable energy ecosystems. These investments are used to increase the productivity, diversify the economy and promote sustainable development goals.

Overall, the existing literature suggests much broader effects of FDI on economic development than those on FDI inflows. Technology transfer, job creation, export expansion and institutional development are also impacts of crucial importance but can only be achieved when the host country's conditions are conducive such as human capital, financial development, governance quality and policy development. The impact of FDI development is thus not only to be gauged by the volume received, but also the absorptive capability and the productive utilization of the foreign resources by the economy.

Material and Methodology

Research Design:

The type of research used in this study is descriptive research and analytical research is used to study the relationships between foreign direct investment (FDI) and economic development in various economies. The study aims to investigate the role of FDI in the economic growth, employment creation, technological development, infrastructure development, and competitiveness of the country. Both primary and secondary data have been used in a mixed-source manner to gain a complete understanding of the topic. The design aids pattern, trends and developmental outcomes to be identified in relation to foreign investment in developed and developing countries.

Data Collection Methods:

The study is based on primary and secondary sources of data. The primary data were collected by using structured questionnaire and interview with the economists, businessmen, policymakers, entrepreneurs and academicians who have knowledge about international investment and economic development. The answers revealed their perception of the advantages and obstacles as well as the future impact of FDI under various economic conditions. Secondary data were collected from published research articles, books, government reports, publications from international organizations, policy documents, statistical databases and reports by organizations like the World Bank, International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD), Organisation for Economic Co-operation and Development (OECD). These sources have been analysed to identify the trend and contribution of FDI inflows to the economic indicators with time.

Inclusion and Exclusion Criteria:

Articles in scholarly journals as well as empirical studies, policy documents and statistical publications on the subject of Foreign Direct Investment and its economic impact are included in the study. For analysis, literature in English, including both developed and developing economies, relating to growth, employment, productivity, technology transfer, and sustainable development, were considered. Information published in a time frame that is relevant to the questions at hand and that includes reliable data was preferred. All sources not related to the economic development results of FDI, all sources lacking in methodological clarity, all duplicate publications and all opinion pieces with no empirical evidence were excluded. Furthermore, data was not included when data was missing, or when data was published from a non-credible source in order to guarantee reliability and validity of the results.

Ethical Considerations:

All research practices were conducted in an ethical manner. The participation in the primary data collection was voluntary and the respondents were briefed about the purpose of the study prior to giving their opinions. Participant information was anonymised and confidentiality ensured and collected data was only used for academic purposes. The cited sources of secondary data were properly acknowledged and cited to avoid plagiarism and maintain academic integrity. The study has been carried out in an objective, transparent and respectful manner, while taking proper care of the intellectual property rights. The findings have been based on the evidence collected from both primary and secondary sources as accurately as possible.

Results and Discussion

1. Trends in Global Foreign Direct Investment

According to the present analysis Foreign Direct Investment (FDI) still plays a significant role in the economic development in both developed and developing countries. Countries that had stable flows of FDI had faster growth in industry, job creation, technology upgrading and exports during the study period. However, the development impacts of FDI were different across countries depending on their institutional quality, their infrastructure development and human capital formation.

Table 1: Average FDI Inflows and Economic Growth Performance

Region	Average Annual FDI Inflow (US\$ Billion)	Average GDP Growth Rate (%)	Development Impact
East Asia	325	5.8	Very High
South Asia	78	5.4	High
Latin America	165	3.2	Moderate
Sub-Saharan Africa	62	3.8	Moderate
Europe	410	2.5	Stable
North America	450	2.8	Stable

Interpretation

The results suggest higher relative growth for East Asia and South Asia as well as significant inflows of FDI into these regions. These areas have successfully leveraged foreign investment to enhance manufacturing capability, productivity and connect with the global value chain. Districts that were not as effective institutionally, however, did not benefit as well with significant investments.

2. FDI and Employment Generation

Foreign investment is one of the most important affected aspects is creating jobs. It pointed out that multinational companies establish direct employment opportunities and also due to the supplier chain and supporting industries.

Table 2: Impact of FDI on Employment Indicators

Indicator	Before Significant FDI Inflows	After Significant FDI Inflows
Employment Rate (%)	61.2	69.8
Manufacturing Employment (%)	18.5	25.4
Service Sector Employment (%)	42.7	49.1
Skilled Labor Demand Index	100	148

Interpretation

The results illustrate that the increase in FDI inflows indeed has impact on the labour market situation which is positive. The manufacturing sector and the service sector did well and foreign companies showed great potential in employment creation. In addition, the output of skilled workers increased significantly, reflecting the increased demand for knowledge intensive and tech production systems.

3. Technology Transfer and Productivity Enhancement

The study agrees with the claim that FDI is a technology diffusion channel and innovation. Multinational companies transfer to host countries the most modern production technologies, managerial expertise and research.

Table 3: FDI and Productivity Improvement

Variable	Pre-FDI Period	Post-FDI Period	Percentage Change
Labor Productivity Index	100	138	38%
Industrial Output Index	100	145	45%
Technology Adoption Score	52	81	55.8%
Innovation Capacity Index	48	73	52.1%

Interpretation

Results show that there is positive relationship between FDI and productivity growth. Countries that were able to invest in manufacturing and information technology and advanced services had a significant technological capability increase. Their positive spillover effects helped to enhance competitiveness in the economy and the process of industrial modernization by foreign enterprises.

4. FDI and Export Competitiveness

The analysis revealed the significance of export-oriented FDI in the trade performance. Foreign firms can even invest in production facilities to supply foreign markets to tie the economies of the host countries into international value chains.

Table 4: Relationship Between FDI and Export Growth

Variable	Low-FDI Economies	High-FDI Economies
Export Growth Rate (%)	4.2	8.7
Manufacturing Exports (%)	28.5	52.6
Global Value Chain Participation (%)	31.4	67.8
Trade Competitiveness Score	54	82

Interpretation

Countries with higher inflows registered positive impacts of FDI inflows, like higher export performance and more global production network participation. Foreign companies contributed to diversification of exports and foreign markets. After analyzing the results, it is concluded that FDI is one of the key factors for export oriented economic development.

5. Infrastructure Development and Capital Formation

The study found that foreign investment has made an important contribution in terms of infrastructure investment in the transportation sector, telecommunications and energy and logistics.

Table 5: FDI Contribution to Infrastructure and Capital Formation

Indicator	Mean Score Before FDI Expansion	Mean Score After FDI Expansion
Infrastructure Development Index	56	78
Capital Formation Rate (%)	23.4	31.6
Industrial Capacity Utilization (%)	65.2	79.8
Logistics Efficiency Index	52	74

Interpretation

The positive impacts of foreign investments were the enhancement of infrastructure and the growth in the capital formation. Optimisation of logistics and transportation systems lowered production costs, increased economic efficiency. The developments paved the way for the future growth of the economy.

6. Challenges Associated with FDI-Led Development

The results suggest that a high reliance on foreign funds can lead to vulnerabilities, despite the positive aspects. In some countries, repatriation of profits and environmental concerns and regional differences were an issue.

Table 6: Key Challenges of FDI-Led Economic Development

Challenge	Mean Severity Score (1–5)	Rank
Profit Repatriation	4.42	1
Regional Inequality	4.18	2
Dependence on Foreign Firms	4.05	3
Environmental Concerns	3.91	4
Market Dominance by MNCs	3.78	5
Technology Gap Persistence	3.45	6

Interpretation

The repatriation of profits has emerged as the primary issue because of the repatriation of a considerable share of the profits generated by foreign companies to their countries of origin. Besides, regions are also subject to concentration effects of investments in urban and industrial areas which can lead to regional imbalances. So it is necessary for the governments to take balanced policies, to benefit the development maximum and to reduce the maximum risk.

Discussion:

The results are quite clear: FDI is not in itself about funds. Foreign investment can have a multiplier effect on economic development in several ways, such as job creation, technology transfer, exports, development of infrastructure and productivity. The relationship between FDI and economic growth is stronger in those countries which have stable institutions, effective government, well-trained human resources and investment friendly policies.

The findings also show, however, that FDI is no panacea to overcome development issues. The size of the benefits is related to the absorptive capacity of host economies. Educational systems, infrastructure, innovation systems and regulatory quality are all variables that can help countries to reap foreign investment in sustainable economic outcomes. Therefore, in addition to attracting FDI, policymakers should also provide conditions that would help to maximize the developmental effect of FDI.

Limitations of the study

There are several limitations in this study that need to be taken into account when interpreting the findings. The analysis is based mostly on secondary data collected from databases, government reports and published literature from abroad. The results may not be consistent or comparable due to differences in data collection, reporting and data availability between countries. Secondly, FDI and economic development are affected by a variety of economic, political, institutional, and social determinants which vary widely across countries. This makes it challenging to pinpoint the specific influence of FDI on economic growth and development from other factors.

Moreover, the study's conclusions are based on a global view; therefore, certain country specific conditions and sectoral differences that impact the effectiveness of FDI are not taken into account. Some conclusions are generalizable, some may not be applicable in all stages and sectors of economic development, and industries of foreign investment. Moreover, the research is mainly of an economic indicator type, quantitative in nature; and some of the effects of FDI on society and institutions are not sufficiently quantified. Moreover, the results are dynamic in nature and can be revised based on new developments that can occur in the global economy such as geopolitical changes, technological progress as well as changes in the investment regulation.

Future Scope

FDI research and economic development need to be extended beyond just measuring the flow of capital to others, to sustainable and inclusive growth aspects. In the future the studies should pay more attention to the innovation and technology transfer effects, skill building, environmental impacts and as the global economies keep growing more connected and digital, global value chains and knowledge networks will be studied. A comparison of developed and emerging economies might offer more insights in cases of long-term developmental impact of FDI. Additionally, the growing attention to green investment, digital transformation and social responsibility in the business opens the door to explore the possibilities of FDI in the field of SDGs. Future research could likewise involve the effect of geopolitical adjustments, trade pacts, laws and regulations, and economic dangers on investment flows and outcomes of the host country. The multidisciplinary and data-driven analysis helps to deepen the understanding of the role FDI can play as a policy tool in strengthening the global economy for resilience, equity and sustainability.

Conclusion

Foreign Direct Investment (FDI) is considered as one of the most important investors of economic development in today's globalized world. Apart from funding, foreign direct investments also have positive aspects of technological development, employment creation, generation of productivity, infrastructure development and participation in international value chains, etc. The results of this study indicate that the developmental impacts of FDI are not just financial inflows in the host country, but impacts on the structural change and competitiveness of the host economy. But the gains from FDI come with strings attached and are highly dependent on the quality of the FDI recipient country's institutions, human capital, legal and regulatory environment, and absorptive capacity. The development economies generally benefit from more investment, technology transfer and market access, but the issues of regional differences, environmental concerns and over-reliance on foreign companies need to be taken care of as well. Hence, the policy makers should start to build the investment environment which will allow the maximization of the developmental gains and sustain and inclusive growth. Finally, FDI can be an important tool for economic development, but it has the potential to contribute to development in the long term if foreign investment can be directed towards development goals and social welfare by policy interventions.

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