International Journal of
Business Diplomacy and Economy

ISSN: 2833-7468
Volume 2 | No 7 | Jul -2023

INWARD FDI AND ECONOMIC GROWTH IN EMERGING AND TRANSITION ECONOMIES

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Abstract: Inward Foreign Direct Investment (FDI) can have a significant impact on the economic growth of both emerging and transition economies. Emerging and transition economies have been central to the global economic growth recent times. These economies are far ahead of developed economies in terms of human capital, but face shortage in financial resources.

This scientific and practical article is devoted to analyses of the inward FDI and economic growth in emerging and transition economies.

Key words: economy, finance, macroeconomy, stabilizing the commercial banks, FDI.

INTRODUCTION

Inward Foreign Direct Investment (FDI) can have a significant impact on the economic growth of both emerging and transition economies. FDI refers to the investment made by a foreign company or individual in a country, with the aim of establishing a lasting interest and control in a business enterprise located in that country. Inward Foreign Direct Investment (FDI) can play a significant role in driving economic growth in emerging and transition economies. FDI refers to the investment made by a foreign company or individual in a domestic company or venture.

Research and analysis.

To analyze the topic properly, it would be worthy to look at some key points highlighting the relationship between inward FDI and economic growth in emerging and transition economies.

Here are some key points to consider regarding the relationship between inward FDI and economic growth in these economies:

Technology Transfer and Knowledge Spillovers: FDI brings with it advanced technology, managerial expertise, and technical know-how, which can help emerging and transition economies upgrade their industries and improve productivity. This technology transfer and knowledge spillover can lead to increased innovation, efficiency, and competitiveness in domestic industries, fostering economic growth.

Capital Formation and Investment: FDI often involves substantial capital inflows into the host country, which can contribute to higher levels of investment. These investments can be directed towards various sectors, such as infrastructure, manufacturing, and services, stimulating economic activity and creating employment opportunities.

Export Expansion: FDI can facilitate access to international markets for emerging and transition economies. Foreign companies often use host country locations as export platforms to serve regional and global markets. This can boost exports, enhance foreign exchange earnings, and contribute to economic growth.

Employment Generation: FDI projects typically require a significant workforce, leading to job creation in the host country. This can help reduce unemployment rates and improve income levels, contributing to overall economic development.

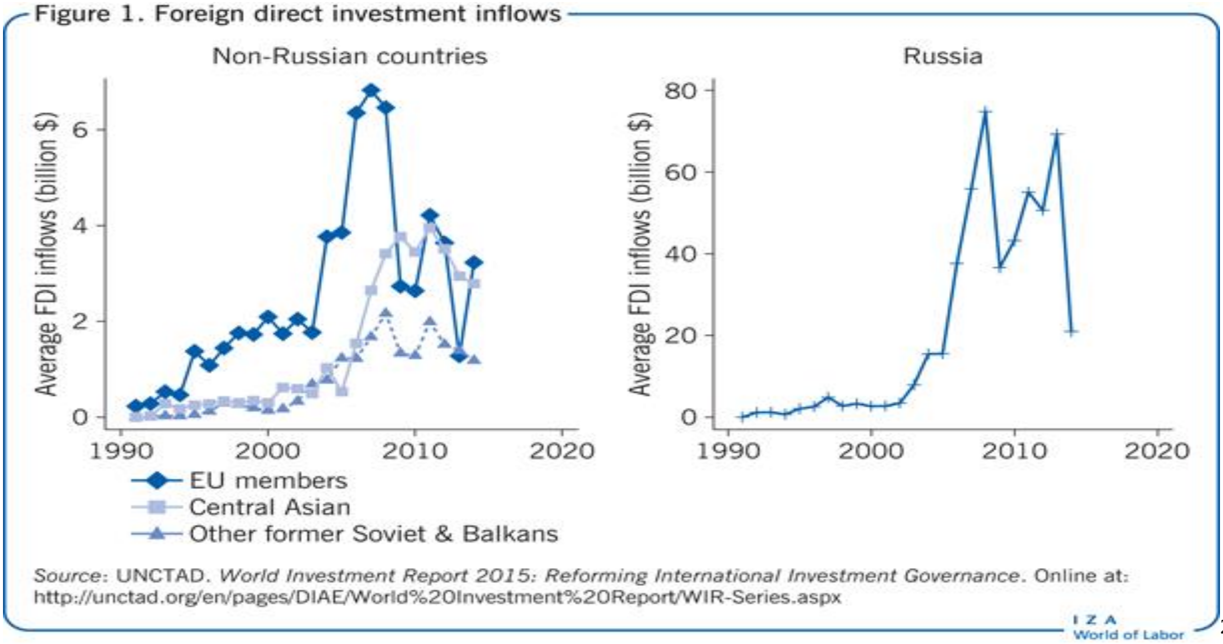
Spillover Effects on Local Firms: Inward FDI can have positive spillover effects on local firms and industries. Through backward linkages, local suppliers and subcontractors may benefit from FDI by gaining access to new markets, technology, and knowledge. This can promote the development of domestic industries and enhance their competitiveness.

Human Capital Development: FDI often requires a skilled workforce, which can lead to the development of human capital in the host country. Foreign firms may provide training programs and knowledge-sharing initiatives, improving the skills of local employees. This can have long-term benefits for the economy by creating a more skilled labor force.

Financial and Institutional Development: Inward FDI can contribute to the development of financial and institutional systems in emerging and transition economies. Foreign investors often require reliable banking systems, legal frameworks, and property rights protections. As host countries strive to attract FDI, they may undertake reforms to strengthen these systems, which can benefit the overall economy.

FDI inflows to the entire transition region relative to unemployment are shown in the Illustration[1]. FDI responded very slowly to the transition process before experiencing a very sharp increase from around 2003; despite setbacks following the recession in 2008, relatively high FDI continued to flow into the region as a whole. Unemployment rose steadily to 2001 and has since been falling. However, as seen in Figure 1, in 1990–2014, there were sharp differences in FDI inflows between the four regions. FDI increased earlier in the EU membership group and rose to higher levels.

Figure 1. Foreign direct investment inflows



Source: UNCTAD. *World Investment Report 2015: Reforming International Investment Governance*. Online at: http://unctad.org/en/pages/DIAE/World%20Investment%20Report/WIR-Series.aspx [2]

These inflows were significant for growth, representing a large proportion of total domestic investment or gross fixed capital formation (GFCF). For example, among EU members, Slovakia received more than one-third of GFCF via FDI between 2000 and 2007; Bulgaria received more than 50% of GFCF via FDI between 2003 and 2008, with a maximum of 99%! In contrast, FDI to Russia

[1] https://wol.iza.org/articles/foreign-direct-investment-and-employment-in-transition-economies/long#izawol.330-figure-000001
[2] https://wol.iza.org/articles/foreign-direct-investment-and-employment-in-transition-economies/long

has been modest, given the scale of the host. Even so, FDI represented more than 10% GFCF after 2003, reaching more than 20% in peak years.

The other two regions, FSU and Central Asia, showed a similar pattern to Russia, but at lower rates of FDI, though even these inflows were often large as a share of GFCF, exceeding 50% in many years in Kazakhstan, Uzbekistan, and Azerbaijan.

Conclusion and solutions.

However, it's important to note that the impact of inward FDI on economic growth can vary across countries and depend on several factors, including the quality of institutions, infrastructure, and policies in the host country. Governments play a crucial role in creating an enabling environment to attract and effectively harness the benefits of FDI for economic growth.

To sum up, the impact of inward FDI on economic growth can be different depending on several factors, including the quality of institutions, the level of human capital, the absorption capacity of the host economy, and the nature of FDI (e.g., greenfield investments vs. mergers and acquisitions). Governments of emerging and transition economies need to adopt appropriate policies and strategies to maximize the positive effects of FDI while minimizing any potential risks or negative externalities.

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