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Relationship Between Foreign Direct Investment (FDI) And Economic Growth

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ABSTRACT

This research demonstrates the significance of sector-specific foreign direct investment (FDI) in determining the beneficial benefits of FDI on economic development and, therefore, which sector ought to be prioritised for liberal policies regarding foreign investment in light of the ability of the domestic economy to absorb foreign investment. It highlights how sectoral foreign direct investment (FDI) enhances development in developing nations, which is a contribution to the little body of material that exists. It is employed to provide policymakers with a realistic tool for the purpose of mobilising foreign direct investment (FDI) in order to maximise economic development that is both inclusive and sustainable.

To summarise, the remaining components of the research were organised as described below. Further discussion is focused on selection of empirical studies that have been conducted for the same areas.

Keywords: *FDI; GDP; employment; economic development*

INTRODUCTION

The World Bank (WB), 2021, states that all national economies strive for economic growth. Sustainable levels of investment and savings (Sredojevic, Cvetanovic, & Boskovic, 2016), technological advancement (Solow, 1956), human capital accumulation (Grossman & Helpman, 1991; Romer, 1990), and global economic integration (United Nations Conference on Trade and Development [UNCTAD], 2003) are all necessary for economic growth to continue. Low productivity causes low income, which causes low savings, which causes low investment, which causes low productivity (Bussman, Soysa, & Oneal, 2005; Masoud, 2014; Welteji, 2018; United Nations [UN], 2020). Regrettably, most developing countries still endure this impasse of underdevelopment. Major obstacles to economic development in developing nations continue include growing debt payment costs to 33 billion USD between 2011 and 2019 and marginalised exports, whose global proportion of exports has stayed at barely 1% since 2010 (UNCTAD, 2022).

Not to mention that many of the world's destitute call these places home. For instance, in 107 developing nations, almost 1.3 billion people—or 22% of the global population—live in multidimensional poverty (World Vision, 2022). In order to alleviate poverty and secure their long-term prosperity, a surge in output and robust economic growth are imperative. Their investment-saving imbalance, fiscal deficit, and current account deficit all work together to limit their economic development. For example, according to UNCTAD (2019), less developed countries had a resource gap of almost 8% of GDP between 2015 and 2017 in terms of domestic savings and gross fixed capital creation. Especially in Turkey, South Africa, Malysia, Argentina, and Kenya, it surpasses 20% of GDP (UN, 2020).

Therefore, in order to escape the cycle of underdevelopment and maintain economic progress, emerging nations need outside resources, like FDI. Developing nations rely on this source of funding more than any other, since it constitutes 39% of all incoming capital (UNCTAD, 2018). Fast economic growth may be induced by foreign direct investment (FDI) by combining local savings with extra capital, better management, marketing, and technology. This breaks the cycle of underdevelopment (Herzer, 2012; Mencinger, 2003). The economic progress of developing nations is fuelled by the use of cheap labour, which has zero or very low marginal products (Ali & Asgher, 2016). Through more tax payments, reduced manufacturing costs, and increasing employment of unskilled labour, it also ensures an equal distribution of money, which boosts economic development and promotes health and education across society (Carp, 2012). According to McCMillan, Page, Booth, and te Velde (2017), it boosts economic growth by boosting exports of

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manufactured goods. Significant economic improvement was also accomplished by the Asian Tiger countries—Taiwan, South Korea, Singapore, and Hong Kong—through huge injections of foreign direct investment (FDI) (Chaudhury, Nanda, & Tyagi, 2020).

The impact of foreign direct investment (FDI) on economic development in the host nation is a topic of debate in the empirical research. Many studies have shown that foreign direct investment (FDI) is a key factor in economic development. Some examples are Agrawal (2015), Ezeji, Promise, and Uzoamaka (2015), Fatmawati, Suman, and Syafitri (2018), Olagbaju and Akinlo (2018), and Dinh, Vo, Vo, and Nguyen (2019). However, several academics argue that it hinders the host country's economic development (Falki (2009), Ludosean (2012), Hossain and Mahammed (2011), Saqib, Masnoon and Rafique (2013), Herzer (2012), Awe (2013), Edrees (2015), and Mohamed and Isak (2017). This is caused by monopolistic rivalry, the remittance of profits back home, and the exploitation of workers and natural resources. Some authors, such as Aga (2014), Belloumi (2014), Ocaya, Ruranga, and Kaberuka (2013), and Ray (2012), contend that foreign direct investment (FDI) does not significantly impact economic growth.

According to Herzer (2012), Mencinger (2003), Pečarić, Kusanović, and Jakovac (2021), and other macro-economic studies, the host country's ability to absorb the investment, including factors like financial development, openness, institutional quality, and the accumulation of human capital, determines the impact on economic growth. For example, Xu (2000) discovered that foreign direct investment (FDI) may only result in positive development if the host nation had a certain minimum level of human capital. This means that foreign direct investment (FDI) helps the host nation expand not only because of the money that comes in, but also because of the knowledge and skills that FDI brings with it. The only way for the host country to absorb, assimilate, and employ this knowledge and skills is to invest in its human capital. Furthermore, according to Aykut and Sayek (2007), nations with well-established financial markets are the only ones that benefit from foreign direct investment (FDI) in terms of growth rates. In order to compete with international enterprises, local firms might take use of the availability of financing to buy the newest machinery, install new technologies to improve old procedures, and engage in research and development. Similarly, Adhikary (2010) said that the imposition of tariffs and non-tariff obstacles to investment, as well as the difficulty in repatriating money and earnings, discourages long-term investments in such nations. This means that economic development is dependent on an economy's openness, as it encourages export-driven foreign direct investment (FDI) and redirects factor endowments to more productive sectors. Foreign direct investment (FDI) and domestic investment (DI) must complement and substitute with one another for FDI-led growth to occur (De-Mello, 1997). only boost economic growth in nations when local and international investments work hand in hand. Foreign direct investment (FDI) is practically useless in the absence of suitable infrastructure, as Thompson (2011) shows that this impact is dependent on the availability of such infrastructure. Also, according to Wang and Wong (2009), high-quality institutions make it easier for foreign direct investment (FDI) to contribute to economic development by boosting inflows, decreasing implementation costs, and improving the ease of doing business. Assuming that all foreign direct investments (FDIs) are of comparable quality is a false premise upon which to build claims about the effects of FDI on economic development. We can't generalise about the economic impact of FDI since different FDIs have different investment absorption capabilities, technical foundations, and even legal environments (Jana, Sahu, & Pandey, 2019). According to Borensztein, De Gregorio, and Lee (1998), a number of academics evaluate greenfield investments as superior to M&A deals, in which foreign companies acquire or combine with domestic ones. Among the several forms of foreign direct investment (FDI), efficiency-seeking FDI is often favoured by academics who want to explain its high quality by pointing to the reasons why foreign businesses engage in it (Adams, 2009). Eller, Haiss, and Steiner (2006) note that some academics use foreign direct investment (FDI) inflows as a measure of its quality, with a bias towards FDI that is sector-specific rather than FDI that is more broadly applicable. This can be due to the fact that not all industries are able to integrate with one another or absorb foreign investment and technology to the same degree. Megaprojects with enormous capital flows are a common kind of foreign direct investment (FDI) in the primary sector, leading to less competition and more rent-seeking (Ali & Asgher, 2016). Since the links and spill-over possibilities in the manufacturing and, in particular, the service sectors are more well defined, FDI in these areas is more likely to increase economic growth than in the primary sector (Jana et al., 2019). Foreign direct investment (FDI) in developing nations' service sectors is mostly in the form of privatisation, and as services are generally non-tradable, they are expected to have a less impact on economic development compared to tradable agricultural and industrial sectors (Aykut & Sayek, 2007). However, when looking at the correlation between FDI and GDP growth, there is a lack of or insufficient precise macro-data that accounts for FDI quality. This section aims to identify some of the features of sector-specific foreign direct investment (FDI) and examines its influence on economic development. The research focused on this aspect because of this constraint. Concerning emerging nations, however, the crucial issue of "Does the sectoral composition of FDI uniquely make a difference in economic growth?" has not yet garnered sufficient consideration. This issue has only been partially addressed by studies that have sought to employ regional or national-level empirical data. For example, in the context of Sub-Saharan Africa (SSA), empirical research has been conducted by Eller et al. (2006), Wang (2009), Ali and Asgher (2016), and Dike (2018); in Asia, it has been conducted by Chaudhury et al. (2020); in

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India and Nigeria, it has been conducted by Chakraborty and Nunnenkamp (2008), Dwivedi and Badge (2013), and Onakoya (2012); however, none of these studies have yielded conclusive or convincing evidence.

Furthermore, no research has been carried out at the level of emerging nations incorporating samples from diverse locations, as far as the author is aware. To the best of our knowledge, this is the first research to look at how foreign direct investment (FDI) by sector affects developing nations' GDP development. Investigating the sector-specific FDI-growth relationship in developing nations by including sampled countries from different regions/continents is important because different sectors of FDI have different potential to generate growth effects due to their linkage and spill-over potential, reliance on external factors, commercialisation of output, and diversification of activities. It is worth noting that prior research did not include institutional quality as a control variable when studying the impact of foreign direct investment (FDI) on economic growth. Additionally, studies that did include institutional quality only used one indicator out of six, which should be considered: government effectiveness, regulatory quality, voice and accountability, rule of law, political stability and absence of violence, and control of corruption. Finally, it tried to include arable land as a control variable, which was not included in the previous research. This is because not included arable land might introduce endogeneity issues, which would cast doubt on the previous results (Luan, Cui, Ferrat, & Nath, 2014).

LITERATURE REVIEW

There are two primary ideas that provide an explanation for the connection between foreign direct investment (FDI) and economic development in developing countries. These theories are the modernisation hypothesis and the reliance theory (Rakhmatullayeva et al., 2020a, 2020b). Based on the work of neoclassical economists (such as Solow, 1956) and endogenous growth theories, modernisation theory asserts that foreign direct investment (FDI) assists developing nations in expanding their economies, absorbing large amounts of labour, and generating large positive externalities, which may lead to an increase in productivity (Hodrab, Maitah, & Kuzmenko, 2015; Sredojevic et al., 2016). Local firms have advantages in terms of the local language, local laws, local regulations, customers, and markets, as well as deals with labour, according to the theories of Vernon (1966), Kindleberger (1969), and Hymer (1976). These theories assume that foreign firms face barriers to entering local markets in developing countries due to imperfect competition. As a result, they proposed that in order for foreign companies to be competitive with domestic companies, they need possess firm-specific advantages such as innovative technology, economies of scale, and trademark rights. It is implied that foreign direct investment will be a source of economic development in developing nations. This will be accomplished by importing cutting-edge technology that is not accessible in the local economy, as well as by optimising the use of labour that is widespread among the jobless and resources that are idle in developing countries. The Howard–Domar growth model and the Rostow linear stage development model both state that high levels of savings and capital accumulation are required for sustainable economic growth. However, these levels of savings and capital accumulation are difficult to achieve in developing nations. As a result, these models recommend the use of foreign direct investment (FDI) to supplement domestic savings and capital in order to maintain economic growth (Hsiao & Shen, 2003).

According to Solow's (1956) growth model, however, capital accumulation has only a short-run influence on economic development rather than a long-run benefit, and technology that is drawn from outside sources, such as foreign direct investment (FDI), is what causes economic growth in the long-run. Foreign direct investment (FDI) plays a critical role in ensuring sustained economic development by the modern sector, as well as in tapping into low-margin labour in agricultural and rural regions for the goal of further industrialisation and growth, according to structural change theories developed by Lewis (1954) and Chenery (1960). Finally, Romer (1990), Aghion and Howitt (1992), and Grossman and Helpman (1991) produced endogenous theories that demonstrated foreign direct investment (FDI) is a significant component in fostering economic growth. This is accomplished via the dissemination of technology (imitation), the acquisition of knowledge through experience, and the encouragement of local businesses to engage in research and development. Furthermore, they argue that "capital deepening in the form of a rise in the variety of capital products available" is beneficial to economic development since it contributes to the advancement of technology.

The dependence theories, on the other hand, assert that developing countries are subject to adverse effects of foreign direct investment (FDI) due to the following: profit repatriation (Mihalache-O'keef & Li, 2011), withdrawal of raw materials (Prebisch, 1959), crowding out effect (Rakhmatullayeva et al., 2020a, 2020b), worsening of income inequality through the exploitation of labour (Chase-Dunn, 1975; Emmanuel, 1972), creation of a dual economy (Santos, 1970), and increased unemployment (Hein, 1992).

Several empirical studies that have been conducted on the topic of foreign direct investment (FDI) and economic development have also yielded contradictory findings. In terms of causation, for instance, Olomola (2004) in Nigeria, Agrawal (2015) in BRICS (Brazil, Russia, India, China, and South Africa), and Reza, Fan, Reza, and Wang (2018) in

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Bangladesh revealed one-way causality that run from foreign direct investment to economic development. These findings were based on the Granger causality test. On the other hand, Ray (2012) in India and Ludosean (2012) in Romania rediscovered the presence of a unidirectional causal relationship that flows from economic development to foreign direct investment (FDI). On the other hand, some researchers, such as Belloumi (2014) in Tunisia, have found evidence of a strong bi-directional association, although Aga (2014) in Turkey found evidence of a relationship that was not significant.

Authors such as Adams (2009) in 42 SSA countries by using ordinary least square (OLS) estimation, Ndiaye and Xu (2016)'s fixed effect (FE) analysis in WAEMU, Fatmawati et al. (2018) FE analysis in Asia, and Dinh et al. (2019)'s VECM analysis in lower-middle-income group countries confirmed that foreign direct investment (FDI) has a significant effect on economic growth by increasing total factor productivity (TFP), creating more job opportunities, advancing technology, and reducing poverty. These findings demonstrate that foreign direct investment (FDI) has a positive impact on economic growth. As a result of profit repatriation and the host country's limited capacity to absorb knowledge and technology transfer for future growth, other authors, such as Falki (2009) and Saqib et al. (2013) in Pakistan, Rahman (2015) in Bangladesha, Mohamed and Isak (2017) in Somalia based on OLS estimation, Herzer (2012) in 44 developing countries based on pane-cointegration estimation, and Awe (2013) in Nigeria based on the two-stage least squares (2SLS) estimation, and Edrees (2015) in 39 SSA countries based on pooled mean group estimation, assert that it has a negative significant effect on economic growth. These authors claim that it has a negative significant effect on economic growth.

The empirical research on the relationship between sector-specific foreign direct investment and economic development did not examine the impact of FDI on economic growth in more than one area or nation. As an example, Eller et al. (2006) discovered a hump-shaped association between foreign direct investment (FDI) in the financial sector and economic development in eleven nations located in Central and Eastern Europe using the regional level. According to the authors' point of view, it makes a contribution to growth after two years and crowds out domestic capital at a certain period if the needed level of human capital is not fulfilled. Aykut and Sayek (2007) conducted research on the impact of foreign direct investment (FDI) on economic development in 33 countries, including both developed and developing nations. Their focus was on the primary sector, industrial sector, and services sector. They discovered that rising manufacturing foreign direct investment (FDI) shares in total FDI had a favourable impact on economic growth, but increased shares of the primary sector in FDI had a negative impact on economic development. In their opinion, the negative impacts of foreign direct investment (FDI) in the primary sector may be linked to the fact that it seeks to get rent, but the beneficial effects of FDI in the manufacturing sector can be related to the fact that it has the potential to establish backwards and forwards links in international economies. According to the findings of a research conducted by Vu, Gangnes, and Noy (2008), foreign direct investment (FDI) in the primary, secondary, and tertiary sectors (transport and real estate) has a favourable and considerable impact on economic development in China and Vietnam. The favourable impacts of foreign direct investment (FDI) on development in India are mostly limited to the manufacturing sector, according to Chakraborty and Nunnenkamp (2008). According to them, neither the primary nor the service sectors have a substantial impact. According to the findings of a research conducted by Wang (2009) in twelve Asian nations, there is substantial evidence to support the beneficial economic impact of foreign direct investment (FDI) in manufacturing, however non-manufacturing FDI did not have any effect.

Furthermore, Doytch and Uctum (2011) discovered that foreign direct investment (FDI) in the manufacturing sector has a favourable and substantial impact on economic development in low-income and middle-income nations, but FDI in the service sector has a much less significant impact. When the foreign direct investment (FDI) in the service sector is categorised into the financial sector and the non-financial sector, the researchers discovered that the financial sector saw a considerable positive influence, while the non-financial sector experienced a negative effect. It has been suggested by Onakoya (2012) that foreign direct investment (FDI) has a favourable correlation with the oil industry in Nigeria, but a negative correlation with agriculture and manufacturing. The findings of Inekwe (2013) indicate that foreign direct investment (FDI) has a favourable correlation with the expansion of the services sector in Nigeria's economy, while it has a negative association with the expansion of the manufacturing sector.

On the other hand, Dar, Bhatti, and Muhammad (2016) note that foreign direct investment (FDI) in both the secondary and tertiary sectors has a notably little impact on the expansion of the economy. Over the period of time between 2000 and 2015, Ali and Asgher (2016) investigated the impact that foreign direct investment (FDI) had on the economic development of five Asian nations in the areas of agriculture, manufacturing, and service. It would seem that the two industries in which foreign direct investment (FDI) inflows have the greatest impact on economic development are agricultural and manufacturing. On the other hand, the impact of FDI inflows into the service sector is almost nonexistent. Manufacturing foreign direct investments are among the finest because of the high marginal return on capital they generate and the backward and forward links they have with other industries.
To be more specific, Dike (2018) investigated the impact of foreign direct investment (FDI) in the agricultural sector on economic growth. He discovered that FDI has a significant and positive impact on economic growth because it

generates employment opportunities for the underprivileged, raises wages, promotes innovation, develops infrastructure, and accomplishes the development of domestic value chains and strategies for international trade. According to the findings of Bucaj (2018)'s OLS estimate, foreign direct investment (FDI) in mining may contribute to the expansion of the economy as a whole in Kosovo. The authors Bunte, Desai, Gbala, Parks, and Runfola (2018) assert that foreign direct investment (FDI) in the natural resources sector in Liberia contributes to the country's economic development because of the strong backward ties with local enterprises. When Hanafy and Marktanner (2019) conducted panel estimations in Egypt using the generalised method of moments (GMM), they discovered that foreign direct investment (FDI) in the primary sector and manufacturing sector did not have any significant impact on economic growth. However, foreign direct investment (FDI) in the service sector did, provided that a minimum requirement for domestic private investment was met.

Jana et al. (2019) conducted a research that assessed the impact of foreign direct investment (FDI) in the agricultural, industrial, and service sectors on the increase of production in each of those sectors. As a result of its inadequate infrastructural foundation and poorer absorption capacity, foreign direct investment (FDI) in the primary sector has a detrimental impact on economic development. On the other hand, FDI in the industrial and service sectors has a beneficial impact. A research conducted in Kosovo by Govori and Fejzullahu (2020) reveals that foreign direct investment (FDI) in the primary sector has a negative impact on economic development owing to the impact of weather vulnerability and variations in global market prices. Furthermore, foreign direct investment (FDI) in the secondary sector has a favourable impact since it offers linking power with other sectors and a big ability to absorb unskilled workers for the economy. The authors Chaudhury et al. (2020) investigated the impact of foreign direct investment (FDI) in the primary, secondary, and tertiary sectors on the rate of economic development in eight South Asian nations between the years 1990 and 2014. Foreign direct investment (FDI) in the primary sector and the service sector is determined to have no significant impact on economic growth. On the other hand, foreign direct investment in the industrial sector often has a negative impact on economic growth. In the secondary sector, foreign direct investment (FDI) often takes the form of mergers and acquisitions (M&As), which leads to the closure of local units and the loss of local employment. Foreign direct investment (FDI) in the industrial sector is said to have negative consequences because of this. In Egypt, Ingham, Read, and Elkomy (2020) argue that foreign direct investment (FDI) in the manufacturing and petroleum sectors has a beneficial impact on the economy. This is in contrast to FDI in the financial, retail trade, communications, and technology sectors, which have a major negative impact on the economy. Foreign direct investment (FDI) that is focused on the market and a low capacity for absorption are to blame for its negative impacts. In addition, the findings of Menyari (2020) indicate that foreign direct investment (FDI) in sectors other than tourism has a considerable and favourable impact on the economy of Morocco, but FDI in tourism has a detrimental impact. The findings of Taylor (2020) indicate that foreign direct investment (FDI) in the primary sector has a positive and statistically significant impact on economic development in Tanzania. On the other hand, FDI in the secondary and tertiary sectors does not have any impact on growth.
For the most part, initially, there has been no research conducted on the impact of foreign direct investment (FDI) on economic development at the level of poor nations. However, there have been studies conducted at regional levels, such as those pertaining to southern Asia or sub-Saharan Africa. The second point is that the findings of the ongoing investigations at both the national and regional levels are in direct opposition to one another. In the third place, the institutional characteristics of countries, as well as the amount of land that is suitable for agricultural purposes, were not taken into consideration in any of the research as a component of absorptive capacity and a possible source of economic development in emerging nations. In light of this, the purpose of this empirical research was to fill in these gaps.

The piece of literature that was shown before may be used to generate hypotheses. For the most part, it is commonly acknowledged that various sectors of the economy offer distinct opportunities for the expansion of capital, the commercialisation of production, and the enhancement of productivity via spillovers. The manufacturing sector is the primary area in which foreign investors make extensive use of intermediate inputs. This practice results in the generation of positive externalities and helps local producers to get access to a greater variety of inputs, which ultimately leads to an increase in productivity. The manufacturing sector is the primary recipient of the technology and expertise that is associated with foreign direct investment (FDI). In the industrial industry sector, there is a diverse variety of linkage-intensive procedures that might be performed. On the other hand, the potential for connections in the primary sector is often seen to be limited. Foreign direct investment (FDI) seeking resources is often concentrated in economically isolated pockets within this industry. Foreign direct investment (FDI) in this industry is notoriously unstable; it is often influenced by fluctuations in the cost of foreign commodities and is typically funded via loans between companies rather than through equity investments. Due to the stronger market strength of foreign service providers, who are "market-seeking" and usually join the host nation via mergers and acquisitions rather than greenfield foreign direct investment, there is a "substantial crowding-out potential." The degree of institutional quality, human capital, economic openness, and financial development of the nations that are receiving foreign direct investment (FDI) is also a factor that determines the influence of this factor. In spite of the fact that foreign direct

investment (FDI) is anticipated to have a beneficial influence on development across all sectors, it is anticipated that FDI in the secondary sector would have a notable growth effect in comparison to FDI in other sectors, followed by FDI in the service sector.

DISCUSSION

Understanding the Connection Between Foreign Direct Investment (FDI) and Economic Development in Developing Countries

Modernisation Hypothesis and Dependence Theory

• Modernisation theory suggests FDI aids in economic expansion, labor absorption, and positive externalities, leading to increased productivity.

• Vernon (1966), Kindleberger (1969), and Hymer (1976) argue that foreign firms face barriers to enter local markets due to imperfect competition.

• These theories suggest that FDI can be a source of economic development by importing advanced technology and optimizing the use of labor.

Solow's Growth Model

• Capital accumulation has a short-term influence on economic development, while technology from outside sources like FDI causes long-term economic growth.

• Structural change theories by Lewis (1954) and Chenery (1960) suggest FDI plays a critical role in sustained economic development and tapping into low-margin labor.

• Romer (1990), Aghion and Howitt (1992), and Grossman and Helpman (1991) argue that FDI is a significant component in fostering economic growth through technology dissemination, knowledge acquisition, and local business research and development.

Dependent Theories on FDI

• Dependence theories suggest adverse effects of FDI on developing countries due to profit repatriation, withdrawal of raw materials, crowding out effect, worsening of income inequality, creation of a dual economy, and increased unemployment.

Empirical Studies on FDI and Economic Development

• Some studies show a one-way causality from FDI to economic development, while others find a bidirectional causal relationship.

• Some researchers find evidence of a strong bi-directional association, while others find no significant relationship.

Final Findings

• Some studies confirm that FDI has a significant effect on economic growth by increasing total factor productivity, creating more job opportunities, advancing technology, and reducing poverty.

• Others argue that FDI has a negative significant effect on economic growth due to profit repatriation and the host country's limited capacity to absorb knowledge and technology transfer.

Research on Foreign Direct Investment and Economic Development

• Eller et al. (2006) found a hump-shaped association between FDI in the financial sector and economic development in Central and Eastern Europe.

• Aykut and Sayek (2007) found that rising manufacturing FDI shares in total FDI had a positive impact on economic growth, while increased shares of the primary sector had a negative impact.

• Vu, Gangnes, and Noy (2008) found that FDI in primary, secondary, and tertiary sectors (transport and real estate) had a favourable and considerable impact on economic development in China and Vietnam.

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• Chakraborty and Nunnenkamp (2008) found that the favourable impacts of FDI on development in India are mostly limited to the manufacturing sector.

• Wang (2009) found substantial evidence to support the beneficial economic impact of FDI in manufacturing, but non-manufacturing FDI did not have any effect.

• Doytch and Uctum (2011) found that FDI in the manufacturing sector has a favourable and substantial impact on economic development in low-income and middle-income nations, but FDI in the service sector has a much less significant impact.

• Onakoya (2012) suggested that FDI has a favourable correlation with the oil industry in Nigeria, but a negative correlation with agriculture and manufacturing.

• Dar, Bhatti, and Muhammad (2016) noted that FDI in both the secondary and tertiary sectors has a notably little impact on the expansion of the economy.

• Ali and Asgher (2016) found that the two industries in which FDI inflows have the greatest impact on economic development are agricultural and manufacturing.

• Dike (2018) found that FDI in the agricultural sector has a significant and positive impact on economic growth because it generates employment opportunities for the underprivileged, raises wages, promotes innovation, develops infrastructure, and accomplishes the development of domestic value chains and strategies for international trade.

• Hanafy and Marktanner (2019) found that FDI in the primary sector and manufacturing sector did not have any significant impact on economic growth, but in the service sector did, provided that a minimum requirement for domestic private investment was met.

Impact of Foreign Direct Investment on Economic Development

• Jana et al. (2019) found that FDI in primary sectors negatively impacts economic development due to inadequate infrastructure and poor absorption capacity.

• In contrast, FDI in industrial and service sectors has a positive impact.

• Govori and Fejzullahu (2020) found that FDI in Kosovo negatively impacts economic development due to weather vulnerability and global market price fluctuations.

• Chaudhury et al. (2020) found no significant impact of FDI in the primary and service sectors on economic growth.
• In Egypt, FDI in manufacturing and petroleum sectors has a positive impact, while in financial, retail trade, communications, and technology sectors, it has a major negative impact.

• Menyari (2020) found that FDI in sectors other than tourism has a significant and positive impact on Morocco's economy, but FDI in tourism has a detrimental impact.

• Taylor (2020) found that FDI in the primary sector has a positive and statistically significant impact on economic development in Tanzania.

• The study aims to fill the gaps in research on the impact of FDI on economic development in poor nations, regional levels, and the institutional characteristics of countries.

• Hypotheses can be generated based on the literature, including the manufacturing sector, industrial industry sector, and the influence of institutional quality, human capital, economic openness, and financial development of receiving countries.

CONCLUSION

Foreign direct investment (FDI) has been linked to economic development in developing countries through two theories: the modernisation hypothesis and the reliance theory. Modernisation theory suggests that FDI helps expand economies, absorb large amounts of labor, and generate positive externalities, leading to increased productivity. It also suggests that foreign firms need firm-specific advantages such as innovative technology, economies of scale, and trademark rights to compete with domestic companies.

The Howard–Domar growth model and the Rostow linear stage development model suggest that high levels of savings and capital accumulation are necessary for sustainable economic growth, but these are challenging to achieve in developing nations. Dependence theories argue that FDI can have adverse effects on developing countries due to

profit repatriation, withdrawal of raw materials, crowding out effect, worsening income inequality, creating a dual economy, and increased unemployment

Empirical studies have shown contradictory findings on the causality of FDI and economic development. Some studies have found a one-way causal relationship, while others have found a bidirectional causal relationship. Some authors have found evidence of a strong bi-directional association, while others have found a negative significant effect.

In conclusion, the connection between FDI and economic development in developing countries is complex and multifaceted. While some studies support the positive impact of FDI, others argue that it can lead to negative effects due to profit repatriation and limited capacity to absorb knowledge and technology transfer.

Empirical research on the relationship between sector-specific foreign direct investment (FDI) and economic development has not examined its impact on economic growth in more than one area or nation. For instance, Eller et al. (2006) found a hump-shaped association between FDI in the financial sector and economic development in Central and Eastern Europe. Aykut and Sayek (2007) found that rising manufacturing FDI shares had a positive impact on economic growth, while increased shares of the primary sector had a negative impact. Vu, Gangnes, and Noy (2008) found that FDI in primary, secondary, and tertiary sectors (transport and real estate) had a favourable and considerable impact on economic development in China and Vietnam. Chakraborty and Nunnenkamp (2008) found that the favourable impacts of FDI on development in India were mostly limited to the manufacturing sector. Beneficial economic impact of FDI in manufacturing, but non-manufacturing FDI did not have any effect. FDI in the manufacturing sector has a favourable and substantial impact on economic development in low-income and middle-income nations, while FDI in the service sector has a much less significant impact.

FDI in the primary sector has a negative impact due to inadequate infrastructure and poor absorption capacity. However, FDI in the secondary sector has a positive impact due to its linking power with other sectors and ability to absorb unskilled workers. The research found no significant impact on economic growth in the primary sector and the service sector. However, FDI in the industrial sector often has a negative impact, leading to mergers and acquisitions (M&As) and local unit closures. In Egypt, FDI in manufacturing and petroleum sectors has a beneficial impact, while financial, retail trade, communications, and technology sectors have a major negative impact.

The study aimed to fill gaps in research on the impact of FDI on economic development at the level of poor nations, as well as the institutional characteristics of countries and land suitable for agriculture. The findings suggest that FDI can have a positive impact on development across all sectors, but it is expected to have a significant growth effect in the secondary sector.

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