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FOREIGN DIRECT INVESTMENTS AND ECONOMIC GROWTH: A CRITICAL LITERATURE REVIEW

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ABSTRACT

The relationship between foreign direct investment (FDI) and economic growth has attracted major attention from academics and the governments of developing countries. Since economic growth is one of their main focuses, FDI attraction-related policies have been prioritized during the process of economic growth and development in these countries. It is widely observed that FDI mitigates the saving-investment imbalance and provides technology which is used for the production of goods and services. Although some studies have found evidence of the positive impact of FDI on economic growth, others have revealed the opposite result. The objective of this paper was to perform a critical theoretical and empirical literature review on foreign direct investments and economic growth. The theories guiding this study included the internalization theory, eclectic paradigm theory, product lifecycle theory, Solow growth model and endogenous growth theory. From the empirical studies reviewed, most studies conclude that foreign direct investments influence economic growth in a positive way but it is also evident that the studies also provide conflicting findings with some oscillating from negative to positive and others indicating no relationship at all. The difference in findings among the scholars might arise from methodological differences and operationalization of the study variables. Contextual differences might also explain the inconsistent findings as most of the studies have focused on developing economies. The study identified preconditions in the host country that help harness FDI and influence economic growth and they include developed financial and legal institutions, proper infrastructure, conducive monetary and fiscal policies, and an enabling macro-economic and structural environment that directs FDI to productive investments.

Key Words: *Foreign Direct Investments, Economic Growth*

1. Introduction

Foreign Direct Investment (FDI) not only offers countries with `much-needed resources for domestic investment but also creates job opportunities, help transfer managerial expertise and technology all contributing to the advancement of the economy (Mishkin & Eakins, 2009). Most governments have appreciated the critical role the FDI plays and have established various ways of attracting it (Adam & Tweneboah, 2009). Many Less Developed Countries (LDCs) particularly in Africa, South America and part of Asia are now giving preference to the potential of FDI in their economies in a bid to pursue growth and development. In many countries, it is evident that FDI provides additional amount of external resources that can contribute to their economic growth (World Bank, 2015). Babatunde (2011) hypothesized that better access to improved infrastructure services is one of the components of a favourable investment climate for foreign investors and an important engine for sustainable economic growth while Dinh, Vo and Nguyen (2019) posit that macro-economic factors may play a role in attracting FDI which will in effect influence economic growth.

1.1Background to the Study

This study will be anchored on several theories such as the internalization theory, eclectic paradigm theory, product life cycle theory, Solow growth model and endogenous growth theory that strive to explain the determinants of FDI in a given country. Internationalization theory by Casson and Buckley (1976) suggests that licensing has major draw backs as a strategy for entering foreign markets as it does not take full advantage of resources available in the foreign country. Eclectic paradigm by Dunning (1993) disputed that location-specific advantage is a substantial significance in illuminating both the justification for as well as trend of FDI. Product life cycle theory explains the stages a new product goes through before the producing firm goes international (Charles, 2008). The Solow model by Solow (1956) explains that economic growth is driven by the factors of labor, capital and exogenous technology. Continuous technological innovation improves on productivity and thus mitigates against the characteristic of diminishing marginal returns of production factors; hence realizing improved economic growth (Musibau, Yusuf & Gold, 2019). The endogenous model by Romer (1986) posits that economic growth is as a result of factor accumulations in labor and capital, plus the important effect of endogenously driven technological innovation (Adusah-Poku, 2016).

Across the world, FDI is an important element for supporting growth of an economy, as a result of this; capital deficient economies thus suffer from low realized FDI due to scarce local resources. FDI play the role of creating employment and thus increasing local income, which then leads to stimulation of local aggregate demand. An increase in local aggregate demand impacts significantly aggregate production output via a multiplier

process. Further to that, an increase in investments can also enhance the productive capacity of the economy, and thereby boost the available capital stock and enhance economic growth of a country (Ali, 2014). Lack of capital thus inhibits the achievement of important goals of economic development such as alleviation of poverty, equal wealth distribution and increased employment levels; a feat only achievable through sustained levels of FDI that enhance growth (Chorn & Siek, 2017).

According to Hill (2005), FDI is an investment made in a corporation by an interested party from another nation for which the company is controlled by a foreign investor. This transaction brings about a long-term association between the host and home country investors (Olson, 2008). According to Ismaila and Imoughele (2010), FDI is a representation of a long-term commitment to the host country. The reason why it is preferable is that this type of investments holds no obligation to the host country. UNCTAD (2002) defines three forms of FDI. They are: reinvested earnings, equity capital and capital consisting of intercompany loans. Employment opportunities are created by FDIs since when businesses set up in the host country, transfer of skills to the locals of the country is enabled through recruitment and training. Apart from new skills, the host country also benefits from technological advancements.

A foreign direct investor may be a corporation, a transnational institution, or a government. Both the foreign direct investor and host country are committed to availing their skills and expertise to the investment operation such as the knowledge of local/ international market and bureaucracy, financial capability, and technical expertise (Moosa, 2002). The long-term nature of the investor-investee relationship gives the foreign investor a huge stake in management (ten percent or more of voting shares), ensuring that both risks and rewards of the enterprise are shared by the parties involved (World Bank, 2016). Success is achieved by developing the industry of interest, and presence of local capital for foreigners to set up or support lucrative businesses in the host country, resulting in growth of various sectors of the economy of the host country. FDI is also useful to local companies wishing to expand, that is, once FDI is initially obtained, incremental FDI inflows in the form of additional capital injections, reinvestment of business earnings, and extension of credits facilities, can also be sought by the investee (World Bank, 2012).

Generally, FDI measurement is based on FDI stock which is expressed as a percentage of the GDP of a country. It is normally published at the end of year with its components being outward Foreign Direct investment stock that includes residences equity investments and credits to foreign countries and inward foreign direct investment stock which is foreigners' equity investment and credits to host economy. The problem with this method is that developing nations are not in possession of the required systems and technology to collect these data efficiently. Along with foreign FDI, FDI flows is also a measure of FDI though its volatile nature makes foreign direct investment stock a suitable measure of FDI as FDI

stock incorporates changes in the economy such as inflation and exchange rate (Nunnenkamp, 2002).

Economic growth means an increase in the average rate of output produce per person usually measured on a per annum basis (Boldeanu & Constantinescu, 2015). It is also the rate of change in national output or income in a given period. Economic growth is the increase of per capita gross domestic product or other indicator of aggregate income (Ofor & Alagba, 2019). Economic growth denotes an increase in the production of goods and services over a specific period (David & Ampah, 2018). According to Haller (2012), economic growth is a process of quantitative, qualitative and structural changes, with a positive impact on economy and on the population's standard of life, whose tendency follows a continuously ascendant trajectory. Economic growth is obtained by an efficient use of the available resources and by increasing the capacity of production of a country (Berry, 2006).

Economic growth creates a legitimate expectation among consumers and investors of continued economic development. This encourages consumer spending and business investment which in turn increases the demand on the money supply moving through the economy (Mogaka, Kiweu & Kamau, 2015). It facilitates the redistribution of incomes between population and society. The cumulative effects, the small differences of the increased growth rates, become big for periods of one decade or more (Boldeanu & Constantinescu, 2015). When the rate of economic growth is big, the production of goods and services rises and, consequently, unemployment rate decreases, the number of job opportunities rises, as well as the population's standard of life (Haller, 2012).

Economic growth is often measured as the rate of change in real gross domestic product (Berry, 2006). GDP is the most frequently used indicator and important for the entire system of national accounting. For an economy, it provides a better snapshot and change in the economy through its growth rate for various sectors. GDP can highlight the comparative strengths for business activities and act as an accurate barometer for all business activities (Aziz & Azmi, 2017). Economic growth is also measured by increases in real gross national income (GNI), is driven by increases in population and/or increases in capital. To increase real GNI per capita, a country must increase the amount of labor, the level of capital and the productivity of either labor or capital (Asabere, McGowan & Lee, 2016).

1.2 Problem of Research

The relationship between foreign direct investments and economic growth of recipient firms has for a long time remained an unresolved subject in academic circles. Findings from extant empirical studies on the subject have been diverse both in substance and form. These divergences have been majorly attributed to three cardinal factors; differences in

methodological approaches, differences in conceptualization of the study variables and differences in contextual settings of the study. There has been no consensus among researchers studying the subject. Some have established a positive linear relationship between foreign direct investments and economic growth (Amondi, 2016; Khun, 2018; Dinh and Nguyen, 2019), others a negative linear relationship (Gunby, Jin and Reed, 2017) whereas others have been non-conclusive on the relationship between foreign direct investments and economic growth (Hanafy, 2015).

From a review of previous empirical studies, a number of contextual, conceptual and methodological gaps have been revealed. For instance, studies by Baiashvili and Gattini (2019), Dinh et al. (2019) and Nketiah-Amponsah and Sarpong (2019) were cross-country in nature and were carried out in various countries. Odidi and Jagong'o (2020), Khun (2018), Ameer and Xu (2017) and Onyieng et al. (2017) established a positive link whereas Nkurunziza (2018) and Gunby et al. (2017) documented an insignificant link. Bouchoucha and Bakari (2019) and Alvarado et al. (2017) establish a negative effect of FDI on economic growth. Malikane and Chitambara (2017) and Waweru and Ochieng (2017) conducted a granger causality test thus establishing a bidirectional relationship while Pandya and Sisombat (2017) and Muli (2019) documented a unidirectional relationship between foreign direct investments and economic growth.

Researchers studying the relationship between foreign direct investments and economic growth have conceptualized the two variables in different diverse ways. These conceptual differences though subtle remain potent when it comes to understanding the divergence in research findings on the relationship between FDI and economic growth. Basu et al. (2003); and Vo et al. (2019) operationalized economic growth as GDP and found a positive relationship. Koojaroenprasit (2012) operationalized economic growth as GDP per capita and found a negative relationship between FDI and economic growth. Khun (2018) operationalized economic growth using Human Development Index (HDI) and GNI. They found a positive relationship between FDI and economic growth operationalized as GNI and no significant relationship when economic growth is operationalized as HDI. Dinh et al. (2019) posits that intervening role of selected variables such as infrastructural development, institutional quality, financial development and human capital development on the relationship between the two variables and moderating role of variables such as macro-economic variables can explain the differences in previous studies.

The divergence in research findings on the subject can also be explained by divergence in methodological approaches adopted by various researchers. Koojaroenprasit (2012) focused on a single-country investigation and examined the impact of FDI on economic growth in Korea over the 1980–2009 period. The author found a strong positive effect of FDI on Korea's economic growth, while human capital, export, and employment also positively affected subsequent growth. There are also many studies that have used cross-

country data. Tiwari and Mutascu (2011) highlighted that both FDI and internationally commercial activity fostered economic growth for 23 Asian countries over the 1986–2008 period. Importantly, they found a profound effect of FDI on growth as an economy was developed. Jyun-Yi and Chih-Chiang (2008) identified no relationship between FDI and economic growth for 62 countries over 1975–2000 period. Similarly, Lyroudi et al. (2014) found no FDI impact on economic growth for emerging markets during 1995–1998. The highlighted research designs, diagnostic tests and tools used, present methodological gaps that require further research to establish the most effective methodology to evaluate and draw conclusion on the relation between FDI and economic growth.

In addition to the above highlighted gaps, divergence in research findings on the subject have also been occasioned by differences in contextual settings. Extant studies on foreign direct investments and economic growth that conclude on existence of a positive relationship between FDI and economic growth have predominantly been domiciled in developed markets: western countries and Asia Pacific countries (Chao et al., 2019; Sridharan et al., 2009) with most of the studies in developing countries arriving at both positive and negative results (Kou et al., 2019). Based on the above highlighted gaps and cognizant to the desire by countries to improve their economic growth through foreign direct investments, this study intended to answer the following questions; what is the effect of foreign direct investments on economic growth? What are the existing knowledge gaps in the study of foreign direct investments and economic growth?

1.3 Research Objectives

The general objective of this study was to investigate the documented relationship between foreign direct investments and economic growth

The specific objectives are;

i. To conduct literature review on the relationship between foreign direct investments and economic growth
ii. To identify the knowledge gaps in the relationship between foreign direct investments and economic growth

1.4 Value of the Study

This review will add on to the available theoretical discussion on the internalization theory, eclectic paradigm theory, product life cycle theory, Solow growth model and endogenous growth theory. The study will also add on to the empirical literature on foreign direct investments and economic growth. Additional, studies may also be carried out based on the recommendation and suggestions for further research.

The study's findings will also be beneficial to investors and practitioners as they will get a deeper understanding on the role played by foreign direct investments on growth and take

the necessary actions to enhance their sustainability. Furthermore, the research shall make contributions to theory in terms of FDI inflows and growth.

The study will also be of value to policymaking organizations like governments, the capital markets, central banks and economic bodies that formulate the various polices on foreign direct investments, financing and economic growth policies. The policy making bodies may also use the study recommendations to come up with effective foreign direct investments strategies to enhance economic growth.

1.5 Organization of the Paper

Chapter one deals with the introduction of the interrelationship among the study variables. It also deals with the definition and operationalization of the study variables, research problem and value of the study. The second chapter commences with the introduction of theoretical review and theories under which the study is anchored. The chapter concludes with a look at the theoretical interrelationship between the study variables. Chapter three deals with empirical relations between the study variables and then gives a literature summary and conceptual framework. Chapter four gives a summary, conclusion and suggestions for future studies.

2. Theoretical Literature Review

2.1 Introduction

The theoretical review chapter documents the various theories guiding the study and the relationship with the study variables as well as the theoretical linkages among the variables under review.

2.2 Theoretical Foundations

This presents reviewed theories that explain the relation between foreign direct investments and economic growth. The theoretical reviews covered are internalization theory, eclectic paradigm theory, product life cycle theory, Solow growth model and endogenous growth theory.

2.2.1 Internalization Theory

This is the anchor theory of the current study. Casson and Buckley (1976) are the proponents of this theory. Additional contributions to the theory were made by Hennart (1982) and Casson (1983). The theory gives an explanation for the growth of multinational entities together with their motives. It explains that these entities structure their internal activities so that they can gain advantages that would improve their competitive edge. Hymer (1976) mentioned that, the occurrence of FDI will only take place when the specific advantages related to a firm are exploited in a manner that will guarantee that the

advantages will outweigh the cost of putting up similar investments abroad. His statement implied that in order for FDI to take place, there should be an existence of imperfect markets and it is a matter of strategy as opposed to a capital market financial decision.

Casson and Buckley (1976) argue that an FDI is only attractive if the Ownership, Location and Internalization (OLI) conditions are met. First, the multinational must have an ownership advantage compared to the local firm's ownership. This may be in form of the multinational's specific organizational or technological knowledge. The government policies' likely on the benefits of investing in a certain host country is also vital. In some cases the host government may pose regulations concerning the nature of foreign ownership. Such restrictions in effect reduce FDI inward inflows which will be accompanied by technology. Secondly, it must be advantageous for the multinational companies as well as other investors to produce in the host country if they can benefit from some comparative locational advantage. Finally, it should be suitable to execute the activities within the host countries, as opposed to leasing or buying them from other firms.

Dragoi (2019) critiques the model because it unrealistically assumes rationality of investors and frictionless markets where investors have all the required information. The theory also ignores the role of technological progress in growth. The theory has over the years further been developed to accommodate an open economy, but however still attributes the inability of an economy to develop squarely on its failure to save and accumulate capital. The relevance of this theory to the current study is that it acknowledges there exist some factors in the host country that determines whether there will be foreign direct investment inflows or not. This study seeks to investigate whether FDI inflows have an influence on economic growth of countries.

2.2.2 Eclectic Paradigm Theory

Dunning (1980) developed this theory by bringing together the structural market imperfections, transaction-cost market imperfections, and location theory, developed the eclectic paradigm of international production. The theory considers the nature of a country's involvement in international relations by analyzing two types of involvement. The first involvement is concerned with economic activities taking place within the boundaries, and thus using national resources, but concerning goods and services directed to foreign market. The second involvement is concerned with activities of national economic agents using resources located in various countries to produce goods and services for foreign market. Dunning (1980) argues that the first involvement falls within the conventional international trade theory. The second involvement falls within the domain of international production and FDI. He further argues that the two are part of the same process. He asserts that in terms of a country's involvement, one has to explain why and when foreign markets are sourced through FDI and international production rather than

production and exports. This approach is an attempt to analyze why and where decisions in terms of ownership, locational and internalization advantages (known as OLI advantages) (Kumar & Kavita, 2017).

The essence of electric approach is in considering those advantages altogether and in applying them to both international trade and production. Ownership advantages (0) are specific to a particular enterprise (such as technology, marketing and production skills). If this advantage is exploited optimally, a firm can overcome and can be compensated for additional costs of establishing production facilities abroad (Dunning, 2000). This advantage also gives the firm the ability for additional costs of establishing production facilities abroad. Locational advantages (L) are specific to countries likely to attract foreign investors. Under these factors such as large markets, government policies, the country's trade policy and tax incentives are included. Finally the firm gets greater benefits by exploiting both ownership and locational advantages by internalization (I). Firms do internalization due to the fact that markets for assets and product such as technology and knowledge are imperfect. The ownership and Internationalization are specific to a particular firm but the location advantages are specific to the host country and have a crucial influence on a host country's inflow of FDI. The advantages must occur jointly for FDI to occur (Olarewaju, 2018).

Dunning's eclectic paradigm suggests that, when ownership, location and internalization advantages are high, firms will prefer an integrated entry mode for example FDI or joint ventures, versus export or licensing. Cyree and Morris (2018) argue that, in the former case strategic asset-seeking investments take place, in which FDI is used in mergers and acquisitions, seeking horizontal efficiency. In the second case, investments are characterized by the search for markets, and resources, thus being of vertical efficiency. The relevance of internalization advantages informs this research. Despite the criticism, the OLI paradigm is dynamic in understanding the importance of foreign direct investment and how it can be enhanced.

2.2.3 Product Lifecycle Theory

This theory was proposed by Vernon (1996) who identifies the four stages of production cycle which are innovation, growth, maturity and decline. In the first stage, companies produce new innovative products for its local market and export any surplus serving markets abroad. Due to increased demand in the markets abroad the companies produce more and export taking advantage of the technology and international competitors. In this first stage as the product grows, the technology becomes exposed. Product imitation starts taking place. Due to completion these firms try manufacture in those countries in order to maintain their market share resulting in FDI. The theory fails to explain FDI arising even without possessing the technological advantage.

The production life cycle by Vernon is typically used in countries that engage in exportation and manufacturing of products. Sometimes, the countries may lose the market share to competitors who imitate the products and end up being the main exporters of the product. The theory explains that diffusion of technological innovations takes place at a much slower rate. As a result, differences are likely to occur in terms of the production technologies used by different countries (Dunning, 1993).

Alvarado et al. (2017) critiques this theory in that the production life cycle described by Vernon is only applicable to certain kinds of products especially those targeting high income earners and products that have alternative labor and capital sources. Critiques have argued that Vernon's theory is silent on industrial innovation which is important in taking transitional advantages on innovations that require a significant amount of rent to develop.

Vernon's evaluation of foreign direct investment solely focused on a product. The innovator produces local market product first which is later exported to foreign countries with little innovative capacity and technology to produce comparable output. Therefore, the produce normalizes leading to maturity. During this level of product growth, labor and other factors of production becomes a critical production input. Consequently, the firm ventures into the foreign country that will provide cheap resources and provide a ready market for the product or service (Chen, 1983). This theory is relevant to the current study as it recognizes a firm's lifecycle stage as the main determinant of FDI inflow.

2.2.4 Solow-Growth Model

The Solow growth model is an exogenous economic growth model that was developed by Robert Solow in 1956. The model extended the Harrod–Domar model by including labor as a production factor, along with non-fixed capital-output ratios overtime. The main argument of the model is that labour productivity and exogenously driven new technological progress is the driving force behind permanent long-run economic growth, since they are instrumental in overcoming the diminishing marginal returns characteristic of production factors (Chowdhury, 2020).

The model thus explains that much of the variation in the growth rates among countries that we see overtime, is a result of the varied technological pace changes and differences among them. It further assumes that production is characterized by returns to scale that are constant, a state that implies that a doubling of production inputs should result into no more or less than output doubling. A very important implication of the model is the convergence hypothesis, i.e. open economies in the long run ultimately converge to their steady state equilibrium levels according to Bogdan (2018), this implies that countries at low levels of development should thus exhibit higher return rates on both human capital and physical capital, than countries at higher levels of development because such are further away from their steady state.

Authors who adopted and used the Solow growth model to investigate the empirical influence of FDI on economic growth include: Musibau, Yusuf and Gold (2019) who adopted an augmented version of the Solow model that includes human capital and found that foreign capital inflows, along with human capital development have had significant impact on Economic Community of West African States (ECOWAS) member countries economic growth. The study affirmed that foreign capital can be a source of capital that can also transmit new technologies that can enhance productive capacity of an economy; just as proposed by the Solow model. On another study, Agbloyor, Abor, Adjasi and Yawson (2014) impliedly adopts the Solow growth model and found a negative influence of private capital flows (private debt flows, foreign equity portfolio investment and FDI) on economic growth; a view contrary to what the model proposes. This theory is relevant to the current study as it recognizes the role played by technological innovations brought about by FDI inflows plays in enhancing a countries economic growth.

2.2.5 Endogenous Growth Theory

Endogenous growth theory was a further development to the Solow growth model and was pioneered by Paul Romer in 1986. This growth model mainly attributes economic growth to factor accumulation in labour and capital, along with effect of endogenously generated technology that improves the productivity capacity of the economy; and hence enhancing economic growth (Samargandi, 2014). The model recognizes that growth is driven endogenously from within the economy through improved innovations in production that arise from research and development efforts. Innovations enhance the existing stock of knowledge and are known to lead to new technologically improved production processes that enhance domestic production, since they are taken to offset the effects of diminishing marginal returns of production factors (Akcigit & Nicholas, 2019).

Human capital investments are enhanced through mobility of labor, skills and training, and via managerial skills and organizational arrangements to meet the production demands created by new technology. The model also advocates for the role of government intervention through appropriate policies that incentivize a higher rate of innovation, while it also recognizes the role private institutions that promote regular innovation through allocation of resources to the development of new knowledge, and via providing incentives for people to be inventive. The model does not predict convergence like the Solow model, but rather explains that the difference between growths of economies lies in endogenously driven technological differences (Chirwa & Odhiambo, 2018).

Authors who have adopted an Endogenous growth model in a bid to investigate the empirical influence of FDI on economic growth include: Adusah-Poku, (2016), who found a positive and significant influence of foreign capital inflows on economic growth. The study proxied the effect of endogenous driven growth using total factor productivity. The

study opined that foreign capital inflows are a source of net technological transfer from more advanced economies, and that these technological transfers stimulate the local economy to innovate in order to compete with the new entrants in the market. This process of endogenously stimulated innovation is posited to be key in long term economic growth. In another study, Anetor (2020) found that FDI and financial development have had a significant and positive impact on growth. As a result, this study emphasized that for FDI to continue stimulating growth via innovation, there is need for a conducive local macroeconomic environment for all investors in the local economy. Similar to the previous study, the role of government was opined and emphasized in promoting sound economic fiscal policies and monetary policies that enhance the financial system and enhance portfolio investments positive impact on growth. The theory is relevant to the current study as it recognizes the role played by human capital investments and technological innovations arising from FDI inflows in enhancing a recipient countries economic growth.

2.3 Knowledge Gaps from Theoretical Review

This section reviews the knowledge gaps that arose from the review of theories on the relationship between foreign direct investments and economic growth. Below are some of the knowledge gaps identified in the review of theories; the internationalization theory and eclectic paradigm theory implies that FDI takes place in countries as multinational corporations are replacing external markets with more efficient internal markets. This hypothesis however does not indicate the expected relationship between FDI and economic growth. Empirical studies carried out to test these theories on the relationship between FDI and economic growth have been inconsistent as most of the studies either have provided mixed results or have failed to reach any definite conclusions. To date, the theoretical relationship between FDI and economic growth nexus has not been conclusive.

While the product life cycle model is a very helpful tool for helping to understand current and potential market conditions, there are some limitations and concerns with the usage of the theory. The main limitation is that, not all new products will be successful. That means that for many new product categories, they will never leave the introduction phase and will never experience growth or maturity. The concept of the product life cycle has been extended and utilized in different forms – some of which is quite acceptable business practice. But the essence of the product life cycle relies upon mapping the overall industry, not a particular firm or a particular product.

The Solow growth model assumes that countries with the similar population rate of growth, rate of savings, and capital depreciation rate will undergo conditional convergence to the same steady state. In reality, the stated factors actually vary across countries and affect the rate of growth differently. There is thus need to further study the effect of differences in population, savings and depreciation rate in the relationship between FDI and economic

growth. The Solow model is also based on the unrealistic assumption that capital is homogeneous and malleable. In reality, capital is highly heterogeneous and hence generally poses aggregation problems. As a result, it is difficult for economies to converge to their steady growth path when a variety of capital goods exist in an economy.

Further studies should thus investigate how various individual but different capital components affect economic growth. The model also ignores the causative agent of technological change and treats growth as an exogenous factor in the process of growth. The model thus ignores the challenges of stimulating technical progress via investment in research and development, the process of learning and capital accumulation, a feature given prominence under the endogenous growth framework. There is thus need to study further how exogenous growth is realized and what role the domestic economy place in stimulating this growth.

The endogenous growth model assumes that technological advances comes from deliberate actions by economies through the public and private, implying that technological advances are based on the creation of new ideas from within the system. However, the model does not factor the role of exogenous factors like foreign direct investment in transmitting new technological progress into an economy, plus other associated benefits from FDI like how in-job training improves human capital productivity. Further studies should thus investigate the role of exogenous factors in stimulating endogenous growth within an economy.

The endogenous growth models ignore the role and impact of some structural changes in influencing local economic growth. External structural changes affect the composition and dynamics of an economy, and thus cause a shift or change in the basic ways a market or economy functions, and hence they warrant consideration in economic growth analysis. Such important factors result from changes in global liquidity and global risk aversion, performance of the world economy relative to the local economy, changes in the availability of resources. Changes in production resources demand and supply, changes in the political landscape and in rules and regulations of business and taxation, changes in a country's foreign reserves and the ever unpredictable and dynamic global economic system. As a result, much more consideration should be laced in investigating to what extent the stated structural changes impact FDI relationship with economic growth.

3. Empirical Literature Review

3.1 Introduction

This section entails the empirical studies by various studies as advanced by various authors around the globe in part 3.2 and a summary of the reviewed empirical studies and research gaps under part 3.3.

3.2 Empirical Review

Under the empirical studies section, various studies related to the study variables, which have been undertaken by various authors around the world, were reviewed to establish the methodologies used and the gaps in those studies. Nguea (2020) sought to investigate the effects of communication, energy and transport infrastructures development on Foreign Direct Investment (FDI) in Cameroon. This study employs autoregressive distributed lag (ARDL) approach to cointegration and an error correction model based on ARDL approach using time series data for the period 1984- 2014. The results revealed that communication infrastructure has a positive and significant impact on FDI in both the long run and the short run. Findings also revealed a negative impact of energy infrastructure in attracting FDI in the long run and in the short run while an insignificant impact of transport infrastructure on FDI is registered in both the long run and the short run. The results suggest that the improvement of business climate trough better infrastructures play a major role in attracting FDI in Cameroon.

Odidi and Jagong'o (2020) aimed at establishing the moderating effect of inflation on the relationship between foreign direct investment, financial market development and economic growth in Kenya. Secondary data collected for analysis was from KNBS economic surveys, World Bank reports, central bank of Kenya's reports, economic journals and annual economic survey reports for a period of 36 years 1980 to 2016. Data analysis was carried out using descriptive and inferential statistics; the study findings revealed that both financial market development and foreign direct investment have positive effect on economic growth in Kenya. However, the interaction term between financial development and inflation rate has a negative effect on economic growth.

Nketiah-Amponsah and Sarpong (2019) investigates the effect of infrastructure and foreign direct investment on economic growth in Sub-Saharan Africa (SSA) using panel data on 46 countries covering the period 2003–2017. The data were analyzed using fixed effects, random effects, and system generalized method of moments estimation techniques. Based on the system GMM estimates, the results indicate that a 1 percent improvement in electricity and transport infrastructure induces growth by 0.09 percent and 0.06 percent, respectively. Additionally, FDI proved to be growth enhancing only when interacted with infrastructure. The interactive effect of FDI and infrastructure improves economic growth

by 0.016 percent. The results suggest that public provision of economic infrastructure reduces the cost of production for multinational enterprises, thus providing an incentive to increase investment in the domestic economy to sustain economic growth. The results also suggest that the impact of FDI on economic growth is maximized when some level of economic infrastructure is available.

Baiashvili and Gattini (2019) concentrate on the impact of FDI inflows on growth and their effect mediated by income levels and the quality of the institutional environment. The study is based on 111 countries, stretching from developed economies to developing and emerging markets starting in 1980. The estimations make use of panel GMM techniques robust to sample size, instrument proliferation and endogeneity concerns. The study finds that FDI benefits do not accrue mechanically and evenly across countries. They detect an inverted-U shaped relationship between countries' income levels and the size of FDI impact on growth. Moving from low to middle-income countries the effect gets larger. On the other hand, it diminishes again transitioning to high income countries. Institutional factors have a mediating positive effect on FDI within country income groups, whereby countries with better-developed institutions relative to their income group peers show a positive impact of FDI on growth.

Muli (2019) sought to investigate the effect of foreign direct investments on GDP and employment in Kenya. To address this problem, the study used time series data for FDI, GDP, employment and other variables as identified in literature for the period 1990-2016. Diagnostic tests of unit root were done to achieve stationarity of the variables used in order to obtain reliable estimates. To address the objectives of this study, the ordinary least squares method was used to explore the effect of FDI on both employment and GDP in Kenya. The study found out that, FDI was an important variable affecting both growth of output and employment in the country. The study recommended adoption of policies that can enhance the flow of FDI to ensure consistent improvement of the variables.

Gachunga (2019) sought to determine the extent to which FDI inflows in the infrastructure sector, the manufacturing sector and the agricultural sector impact Kenya's economic growth. Quantitative data were used in the study to answer the study equation. The researchers collected level two data from the World Bank and the Kenya National Bureau of Statistics KNBS from 2000 to 2017. In order to analyses growth within or between countries the augmented Solow model developed by Mankiw (1992) was able to include variables associated with trade foreign direct investments. The results of the study show that FDI in the infrastructure sector has had a positive and significant impact on economic growth while the manufacturing and agriculture sectors have had a positive although such positive effect were insignificant. Unlike the manufacturing sector foreign direct investment inflows to the agricultural sector are relatively small and this may be the cause of little impact.

Dinh et al. (2019) examines and provides additional and relevant quantitative evidence on the impact of foreign direct investment on economic growth, both in the short run and the long run in developing countries of the lower-middle-income group in 2000–2014. Various econometric methods are employed such as the panel-based unit root test, Johansen cointegration test, vector error correction model (VECM), and fully modified ordinary least square to ensure the robustness of the findings. The results of this study show that FDI helps stimulate economic growth in the long run, although it has a negative impact in the short run for the countries in this study. Other macroeconomic factors also play an important role in explaining economic growth in these countries. Money supply has a positive effect on growth in the short run while total credit for private sector has a negative effect. In addition, long-run economic growth is driven by money supply, human capital, total domestic investment, and domestic credit for the private sector.

Bouchoucha and Bakari (2019) analyzed the impact of domestic investment and FDI on economic growth in Tunisia during the period 1976–2017. This study was based on the Auto-Regressive Distributive Lags (ARDL) approach that is proposed by Pesaran et al. (2001). According to the results of the analysis, domestic investment and foreign direct investment have a negative effect on economic growth in the long run. However, in the short run, only domestic investment causes economic growth. The findings are important for Tunisian economic policy makers to undertake the effective policies that can promote and lead domestic and foreign investments to boost economic growth.

Khun (2018) sought to investigate the impact of FDI on the economic growth of Cambodia by utilizing the time series data throughout 2006-2016. The correlation matrix and multiple regression analysis techniques were used to analyze the collected data. The results of the study reveal that FDI has a positive impact on the economic growth of Cambodia. The study recommends that government should bring reforms in the domestic market to attract more FDI in Cambodia.

Nkurunziza (2018) sought to assess the impact of foreign direct investment on the economic growth in Rwanda over the period of 1970 to 2014. The study has examined time series data over a period of forty-four years. Multiple regression technique and EViews 10 econometric software were utilized to measure the relationship between independent (FDI) and dependent variable (GDP growth). The result showed the positive but not statistically significant influence of the foreign direct investment on the economic growth in Rwanda.

Marozva and Makoni (2018) explore the relationship between FDI, infrastructural development and economic growth using a panel of nine African countries, over the period 2009 -2016. There is no single economic theory, which explains the effect of infrastructure on economic growth. Using panel data analysis, the results from Fixed Effects model show that economic growth is positively related to both infrastructure development and FDI.

However, the relationship is not significant. Furthermore, government spending and domestic credit to the private sector are positively related to economic growth and the relationship is significant. It is therefore recommended that the Governments of these African countries intervene and put policies in place to develop their local infrastructure so that it can further grow its economy, thereby increasing employment and trade opportunities, especially if it wishes to attract foreign investors. Also, African countries are encouraged to put in place polices that promotes political stability, property rights, human rights and rule of law in order to attract FDI.

Gunby et al. (2017) investigates the role of FDI in China's economic growth. They apply meta-analysis to the corresponding empirical literature to find an answer. Their main finding is that the effect of FDI on Chinese economic growth is much smaller than one would expect from a naïve aggregation of existing estimates. Publication bias and a profusion of estimates based on less preferred study and sample characteristics have served to inflate observed estimates. Once these effects are accounted for, the estimated effect of FDI on Chinese economic growth is reduced to statistical insignificance. This suggests that the cause(s) of the Chinese "economic miracle" likely lie elsewhere.

Muigai and Muturi (2017) examined the influence of FDI inflows on Kenya's economic growth. The study period was from 2000 to 2015 and used panel data collected using a data collection sheet. A causal research design and Ordinary Least squares method were used. The findings established that there was a weak influence of FDI inflow and GDP of Kenya. To increase the effect of FDI on economic growth, the study posited that the government needs to direct foreign resources to more productive areas in the economy. The study also revealed a negative relationship between foreign debt and Kenya's economic growth. This is largely due to poor debt management that is coupled with the use of such funds in social consumption instead of productive ventures.

Haq et al. (2017) conducted a study to review the effect of FDI on economic growth in six Asian countries namely: India, Pakistan, Sri Lanka and Bangladesh from south Asia, along with Indonesia and Malaysia from East Asia. The period under review was 1990-2013, and the study was based on Pooled Ordinary Least Square (OLS) estimation. In the long run, FDI inflows were found to largely explain economic growth in the selected Asian countries. Also, the study found that physical capital and trade openness positively affect economic growth.

Ameer and Xu (2017) investigated the long-run effect of inward and outward foreign direct investment on economic growth: evidence from 28 developing economies over time period 2005-2014 annually. The study employed the OLS and GMM on the basis of macroeconomics panel data in developing economies. The study found that there is a positive and significant impact of foreign direct investment outflows and inflows on

economic growth in the long run among developing economies. Further, the positive and significant effects of foreign direct investments inflows and outflows on economic growth were highly robust when different econometric techniques were employed.

Alvarado, Iñiguez and Ponce (2017) examine the effect of foreign direct investment on economic growth in 19 Latin American countries. Using panel data econometrics, they found robust empirical evidence that suggests that the effect of FDI on economic growth is not statistically significant in aggregated form. This result varies when they incorporate the levels of development reached by the countries in the region. FDI has a positive and significant effect on product in high-income countries, while in upper-middle-income countries the effect is uneven and non-significant. Finally, the effect in lower-middle-income countries is negative and statistically significant. The results show that FDI is not an adequate mechanism to accelerate economic growth in Latin America, with the exception of high-income countries.

Pandya and Sisombat (2017) examine foreign direct investment inflows and its impact on economic growth in Australia. The paper examines the relationship between FDI and economic growth of Australia through regression analysis between FDI and different measures of economic growth. The multiple regressions is used to derive conclusion on importance of FDI. The result reflects absence of relationship between FDI and economic growth of Australia as two out three variables show poor relationship with FDI.

Waweru and Ochieng (2017) examined the immediate and lagged impact of FDI flows on Kenya's economic growth. The study period was from 1984 to 2014, representing a 30-year period. The study applied a quantitative research design. This was an econometric model form known as Auto Regressive Distributed Lag Model (ARDLM). The study results were that portfolio investments flows and foreign direct investments have had a negatively statistically insignificant effect on the GDP growth rate. Further, other investments flows, have had a positive and statistically significant impact on economic growth.

Wekesa, Wawire and Kosimbei (2016) sought to determine the effects of transport, energy, communication and water and waste infrastructure development on FDI inflows in Kenya. The study used annual time series data sourced from Central Bank of Kenya, World Bank and the United Nations Conference on Trade and Development (UNCTAD). Using multiple regression analysis, it was established that improved transport infrastructure, communication infrastructure, water and waste infrastructure, exchange rate, economic growth and trade openness are important determinants of FDI inflows into Kenya. Hence, for Kenya to attract more FDI, continued infrastructural development is key since quality infrastructure affords investors a conducive investment climate in which to operate.

Kimotho (2015) adopted a descriptive survey to study the effect of FDI on economic growth in Kenya between the years 2005 and 2014. The study had three findings, firstly, that capital injections like FDI enable nations to accumulate capital faster, that is, it allows them to import more than they export, thereby enabling them to invest more than they save, and boosting labor productivity and wages. Secondly, FDI has the capacity to create employment for some educated folk in the rural and urban informal sectors. Thirdly, FDI is able to transfer technology and expertise, therefore spurring the productivity of local firms. The study concludes that there exists a correlation between FDI and economic growth.

Khadenje (2015) used secondary data to evaluate the impact of FDI on economic growth in Kenya for the period 1995-2015, using multiple regression analysis and correlation. The research concluded that, FDI and economic growth in Kenya show a strong positive correlation. The relationship between FDI and the other variables e.g. interest rates and foreign exchange rates also showed a direct proportional relationship.

3.3 Summary of Empirical Review and Research Gaps

A number of studies were reviewed with a number of contextual, conceptual and methodological gaps being revealed. Conceptual gaps came in the form of differences in the operationalization of the variables of interest. FDI was operationalized as an aggregate lumpsum amount, while others disaggregated FDI into individual components based on their common underlying characteristics like foreign equity, reinvested earnings and loans. Others also classified FDI into either inflows or outflows. Economic growth was also operationalized differently as HDI, GDP, GDP growth rate and GNI. The lack of consensus in operationalization and on the findings on the direction of the relationship, present a conceptual gap that requires further study to establish the most effective way to define the scope of the variables of FDI and economic growth; along with the direction of the relationship between FDI and economic growth.

Other conceptual gaps include the lack of studies that evaluate the intervening role of selected variables such as infrastructural development, institutional quality, financial development and human capital development on the relationship between the two variables. Also, there are conceptual gaps in relation to the moderating role of variables such as interest rates, inflation, exchange rate, money supply, unemployment rate, political stability, and fiscal and monetary policy decision on the relation between FDI and economic growth.

Methodological gaps in the studies include the use of different research designs and analytical methods and tools to conduct research the relationship between FDI and economic growth. Among the research design methods used by various researchers are the descriptive analytical research and quantitative research design. The different analytical

and diagnostics tests used include: Granger causality, Ordinary least squares, Johansen cointegration, Multiple regression technique, Pooled Mean Group estimator, Auto regressive distributed lag model, Pooled ordinary least square estimation, Panel fixed-effects estimation, Vector error correction model, Panel unit root test, Panel co-integration test, panel regression model (Fixed or random effect), Least square regression, impulse response function as well as forecast error variance decomposition of structural. The highlighted research designs, diagnostic tests and tools used, present methodological gaps that require further research to establish the most effective methodology to evaluate and draw conclusion on the relation between FDI and economic growth.

Contextual gaps from the review of empirical studies were manifested through differences in research settings. Contextual gaps have also arisen from the reviewed empirical works. Most of the work has been biased towards emerging and developing countries and regions like Sub-Saharan Africa and Asia. The common feature among these economies is that they mostly suffer from resource deficiency and scarcity, and are thus all recipient economies of FDI. A contextual gap thus results in that there is need to conduct further studies on how advanced economies and FDI source countries are impacted economically through their deployment of capital into this resource scarce and recipient economies. These gaps have shown that research on FDI and economic growth relationship still has several grey areas with no empirical consensus. The study therefore highlights these glaring research gaps based upon which recommendations for future research on the subject area will be done.

3.4 Conceptual Framework

The model below portrays the expected association between the study variables. The independent variable for the study is foreign direct investments. Infrastructure in the recipient country is theoretically expected to mediate the relationship between the study variables while macro-economic variables act as the moderating variable. Economic growth as measured by GDP per capita is the dependent variable. The conceptual framework for this study has been developed after a meticulous literature and empirical reviews. Figure 3.1 depict the study's conceptual model.

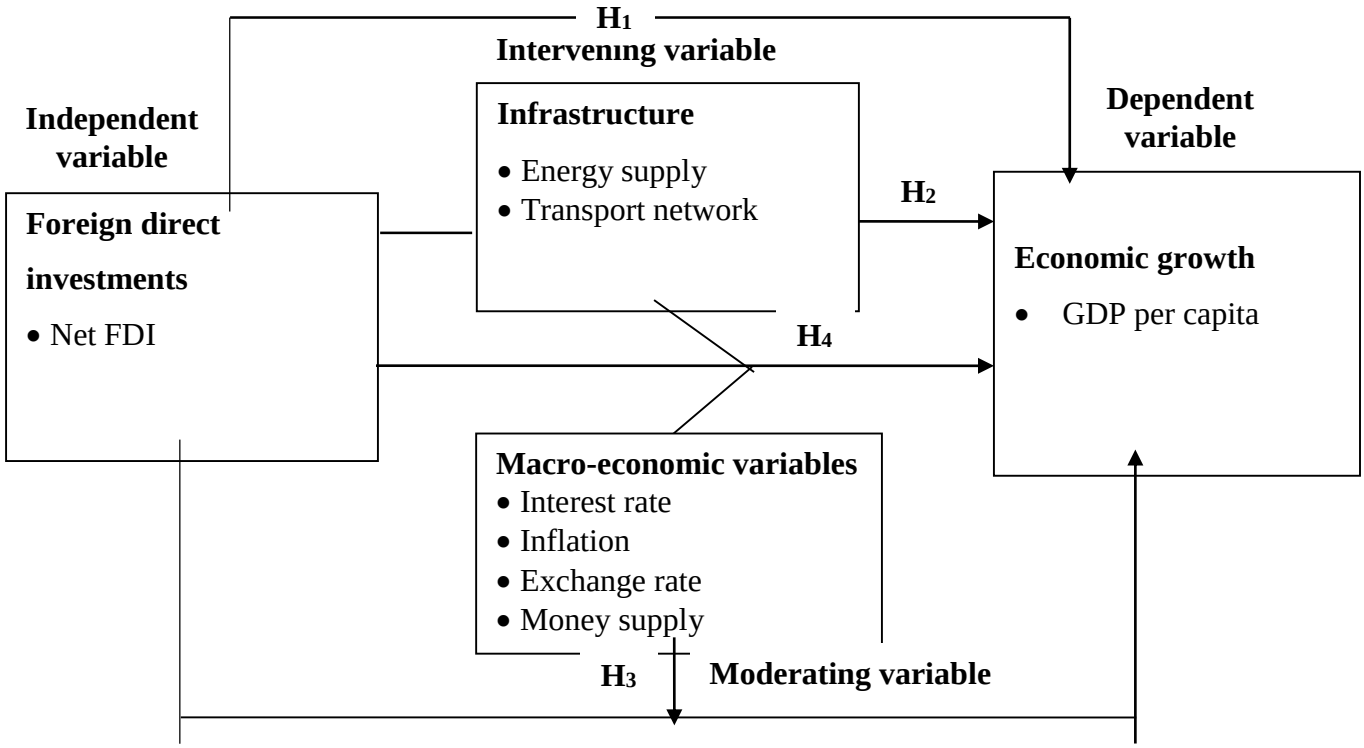

Figure 3.1: Conceptual Model

Source: Author (2020)

4.Summary, Conclusions and Recommendations

4.1 Summary

This study aimed at reviewed the theoretical and the empirical literature on foreign direct investments and economic growth to document knowledge gaps and guide on further

studies on the variables. This study was purely a desktop research which specifically explored theoretical and empirical literature on the link between foreign direct investments and economic growth and respective literature on the variables reviewed.

The literature review on foreign direct investments documented that the key indicators for foreign direct investments were FDI inflows and outflows but they can also be classified in terms of foreign equity, reinvestment earnings and company loans while the key measures for economic growth were GDP, GDP per capita and GNI respectively. There are also studies that have operationalized economic growth in terms of human development index and GDP growth rate. Few studies have also operationalized FDI in terms of the sector the investment goes to such as infrastructure, agriculture, tourism, manufacturing among others.

From the critical literature review it was evident that foreign direct investments affect economic growth. However, the findings were varied with some studies indicating the existence of negative relationship an indication that an increase in FDI adversely affects economic growth. Some studies however documented a positive relationship thus an indication that a unit increase in foreign direct investments positively affects economic growth. Other studies documented the existence of insignificant relationship among the considered study variables. However, the studies were all carried out using varied methodologies and data was collected for different time periods which could be the justification for the varied results. The study contexts were also different with some studies focusing on a single country and other focusing on several countries. Some studies also revealed that a host country infrastructure has an intervening role between the study variables while some studies argued on the influence of macroeconomic environment on the relationship between FDI and economic growth.

4.2 Conclusion

The empirical studies reviewed suggest that foreign direct investments indeed do have the capacity to affect economic growth in a positive, negative or even have no effect on growth. Thus, FDI is a viable source of capital that can be utilized locally to supplement domestic savings, or can also be a source of the desired physical capital for investment in an economy that can ensure continuous economic growth. The nature of this relationship however, varies among different economies. The impact of this relationship has been found to vary based on the form and individual component of foreign direct investments going into an economy. Thus, a country requires finding out and attracting the FDI component that has the greatest impact on its growth, and capitalizing on that to boost its comparative advantage relative to other countries.

Based on reviewed literature, for foreign direct investments to positively impact economic growth, researchers have posited that a host country must ensure that there is an enabling

domestic environment that attracts and directs FDI to priority and productive local investment areas. An enabling local environment can be created through the government via fiscal and monetary policies that support and encourage foreign investment. Also, more to that the economic state of the country playing host to the FDI relative to the economic wellbeing of the overall world economy matters in attracting FDI into an economy. A decrease in global risk aversion and an increase in global liquidity generally tends to favor increased movement in FDI worldwide.

The study also concludes that there are pre-conditions that have been posited to enhance the absorptive capacity of an economy to FDI, these include: a threshold level of financial and human capital development, locational or production externalities in a host country, stable political environment, a degree of economic openness, available infrastructure, developed local financial markets, sound and credible fiscal and monetary economic policies that will be aimed at attracting productive capital inflows, supportive institutions like the legal environment and financial regulation, among others. The presences of these factors and conditions have been cited to enable a host country harnesses the benefits associated with FDI, and have enhanced positive economic growth.

4.3 Knowledge Gaps

It is evident from the reviewed literature on foreign direct investments and economic growth that the divergence in research findings on this subject can be attributed to the following research gaps; conceptual gaps, contextual gaps and methodological gaps. At the conceptual level, different researchers who adopted different proxies for FDI and economic growth and different theories when explaining the relationship between the study variables established different conflicting findings. Economic growth was proxied by; GDP, GDP per capita, GNI, GDP growth rate and HDI whereas foreign direct investments was proxied by both inward and outward FDI. Theories adopted on the other hand included; internalization theory, eclectic paradigm theory, product lifecycle theory, Solow-growth model and endogenous growth theory.

The decision not to consider other variables that might influence the relationship between FDI and economic growth like; moderating variable, intervening variables, control variables and extraneous variables remains a glaring conceptual gap that needs to be addressed. Some of the variables that were omitted in the studies but ought to have been considered include; macro-economic factors such as inflation, exchange rate, interest rates, money supply, political stability among others given their hypothesized influence on the relationship between FDI and economic growth; infrastructural development in the host country as an intervening variable given the fact that foreign direct investments funding leads to infrastructural development which is then hypothesized to influence economic growth; institutional quality as a control variable given its influence on the strength of the

relationship between FDI and economic growth; democracy and prevailing regulatory environment as extraneous variables given their indirect influence on the dependent variable despite not being part of the dependent variable.

More to that, the studies varied in time periods under review, and there is need to review the short term and long run influence of the relationship as suppliers of FDI invest capital and repatriate back profits. Conceptually some studies did not factor periods of extreme economic changes like during financial crises, whereas such periods tend to exhibit outlier data that may need moderation to allow for a more uniform comparison across regions. The studies did not analyze separately the effects of FDI inflows and FDI outflows separately to gauge their respective impacts on economic growth.

At the methodological level, different research methodologies were adopted by different researchers studying the subject leading to different findings as expounded in the review of empirical studies. These methodologies included univariate analysis and multivariate analysis. Future related studies should therefore strive to bridge this gap by investigating the research methodology to be adopted in investigating the relationship between the two variables.

From a contextual perspective, most of the studies done were mostly in emerging economies and developing countries, these failed to consider their varying differences in economic, structural and social factors, that require adjusting in order to allow for better comparison across varying regions. To fill this contextual gap, more research thus needs to be performed on developed and advanced economies on the nature of the relationship, since of late they have also become a popular destination for FDI; especially during times of increased global financial risk aversion, when most global investors direct capital to more advanced economies as they look for safer reserve currencies to hold assets.

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