

Kayani, Farrukh Nawaz; Al-Ammary, Omar Mahmoud; Misbah Sadiq

Article

Inward FDI and economic growth nexus: A case of emerging Brazil from Latin America

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Inward FDI and Economic Growth Nexus: A Case of Emerging Brazil from Latin America

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Farrukh Nawaz Kayani 

Al Qasimia University, Department of Economics, United Arab Emirates

Omar Mahmoud Al-Ammary

Al Qasimia University, Department of Economics, United Arab Emirates

Misbah Sadiq 

Al Qasimia University, Department of Economics, United Arab Emirates

Abstract

Capital stock is possessing pivotal importance in stimulating the economic growth and development of any country. Inward FDI is considered as one of the important catalysts of economic development particularly for the resource and capital poor countries. In this article we have examined the relationship between inward FDI and economic growth in case of one of the emerging economies of Latin America i.e., Brazil. We took annual time series data for the dependent and independent variables like inward FDI, per capita Gross Domestic Product (GDP), employment, capital formation, and exports for the period ranging from 1996 to 2019. We ran Ordinary Least Square Regression and Random Effect Regression Analysis for gauging the nature of relationship between the variables as well as for testing the robustness of the results. We found that FDI has a positive and significant relationship with GDP and the exports. Whereas, FDI has insignificant relationship with the employment and capital formation. The article holds an important policy implication for the other developing countries of Latin America; they need to attract good amount of inward FDI to achieve the robust economic growth and development.

Keywords

Brazil, Inward FDI, Economic Growth, Exports, Employment, Capital Formation, Latin America.

JEL Classification

F21, F23, F43

Introduction

Foreign Direct Investment (FDI) is one of the major determinants of economic development as it brings immensely tremendous growth opportunities for the receiving country. The enormous economic impact of FDI can be attributed to its ability to benefit both the host and the foreign countries. The World Trade Organization defines FDI as: The activity carried out by the investor residing in a country (the home country) and through which he uses his assets in other countries (host countries) with intent to operate it (Alicia, 2008). Foreign countries mostly reap financial rewards in the form of low-cost operations resulting in greater profit margins for the investors and host countries benefit in the shape of increased economic growth of their country. In addition, FDI has a direct impact on the tax rates, inflation levels, and extent of government spending which ultimately administers the rate of GDP growth in the recipient country. The influx of technology and infrastructure development through inward FDI has favorable outcomes for the short-run and long-term economic growth of the host country. When foreign companies bring their operations into the host country, they bring with them advanced technology, knowledge, and resources which ultimately stimulates the economic health of the country.

Inward FDI exerts positive technological spillover effects for the recipient country. Policy makers across the globe has weighted the FDI as key parameter in economic growth or revival of any country due to its bridging effect between technology and the resource gap (Kayani, 2017). Over the past few decades, Brazil has succeeded in attracting the good amount of foreign capital because of effective policies being undertaken by the government to stimulate the flow of FDI into the country. Some of their major efforts include the Plano Real reforms that were introduced by Brazil in 1994 with the intention of attracting investments from foreign companies and the individuals (Shahzad, Hussain, Qin, & Muhamadi, 2019). The success of these measures was depicted in the

Corresponding author:

Farrukh Nawaz Kayani, Al Qasimia University, Department of Economics, United Arab Emirates
Email: fkayani@alqasimia.ac.ae

tremendous rise of inward FDI being experienced by Brazil since their implementation. With the effective enforcement of Plano Real reforms, the country became noticeably more attractive to foreign investors as the value grew from 3.072 billion to 69.174 billion in 2019 (World Bank, 2020). While the political instability and prevalence of social crime hindered the country from sustaining itself as a prospective economy for the investors, the geographic location of Brazil and the availability of required resources have significantly helped the country to tap good amount of FDI. The industrial base of Brazil is also an added incentive to foreign investors which has played a major role in attracting FDI into the country.

Brazil is an active and important member of the BRICS association whose foundation was laid down in 2001 primarily to promote peace and international cooperation among the members of the group and other countries. Since its inception, being a part of BRICS has also proven to be quite beneficial for Brazil in terms of attracting good amount of FDI. Brazil offers investors huge incentives such as access to cheap labor, low-cost natural resources, and a potential target market which is reflected in the rising trend of FDI flow into the country. According to the World Investment Report, Brazil ranked 9th among the primary recipient countries of FDI as it accounts for a significant share of the total global FDI. The report also stated that a 20% increase in FDI was reported by Brazil in 2019 which is considered tremendous when compared to the statistics of other host economies (UNCTAD, 2020).

Besides bringing good investment into the country, FDI also poses a positive impact upon major development indicators of the economy. For instance, the introduction of a new venture increases employment opportunities and enhances the skill set of the hired labor eventually resulting in greater human capital accumulation. In addition, the installation of new equipment provides the citizens of the host country with an opportunity to learn how the new machinery operates and elevate their creative capacity to enhance the labor productivity. In the view of different economists and the econometricians the economic growth is caused due to increase in overall productivity level (Kayani, 2017). It is for this very reason that FDI has proven to be an essential vehicle of economic growth especially among emerging economies like Brazil (Prabhakar, Azam, Bakhtyar, & Ibrahim, 2015). The adoption of modern techniques of conducting business and the industrial advancement induced by the inflow of FDI in Brazil has helped to facilitate the socio-economic development efforts of the country (Jomit & Joseph, 2018).

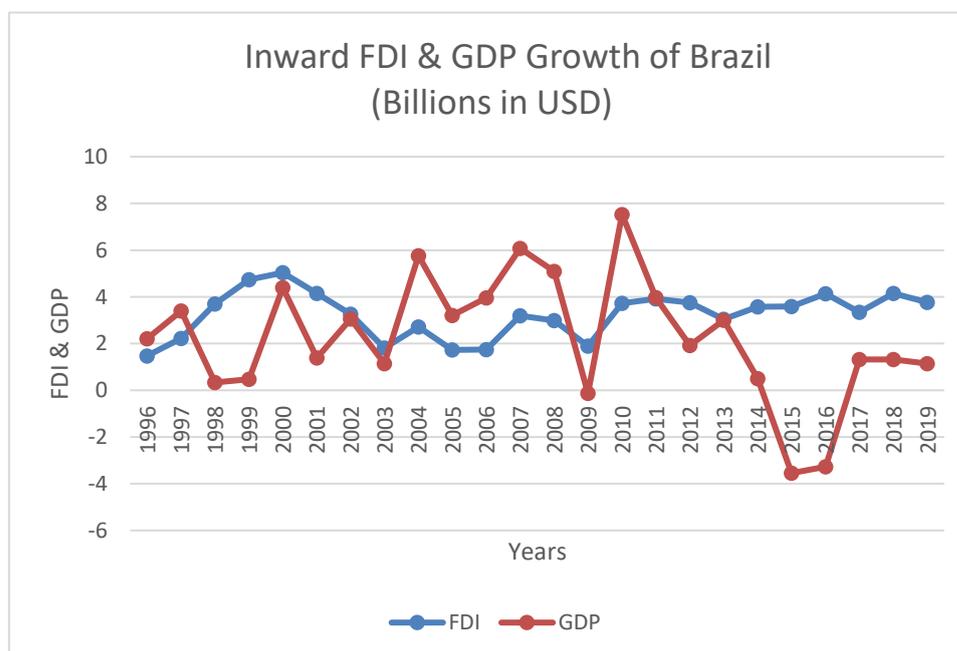


Fig. 1. Inward FDI & GDP Growth of Brazil.
Source: World Development Indicators

COVID-19 has plunged the world economies into deepest recession with unprecedented and historical levels of poverty, deprivation, and unemployment (Aysan, Kayani, & Kayani, 2020). But it is noteworthy that Brazil showcased an applaudable response to the outbreak of the coronavirus pandemic to facilitate and assist the investments being made by the foreigners. The crisis management techniques of Brazil proved to be quite successful as they took immediate measures to sustain the flow of capital funding being received by the country. The intelligence team of Brazil developed an online market intelligence tool to keep the investors updated on the changing economic trends which might potentially influence the profit margin that they intend to generate from their investments (UNCTAD, 2020). Moreover, they also introduced an online platform intended to keep the investors informed regarding how the pandemic unfolded in their region of interest. Such measures undertaken by the government of Brazil allowed for uninterrupted investment activities to be taken place because of which

the country continued to experience the unhalted economic growth even during the pandemic. Therefore, it is important to examine the relationship between FDI and economic growth in case of Brazil. As per the authors knowledge no recent study has examined the effects of FDI and economic growth in case of Brazil. This study contributes in following ways. Firstly, this is the latest and updated study that has considered the period from 1996 till 2019. Secondly, this study has carried out the results robustness and confirms the results obtained by OLS regression. Thirdly, this study has provided various practical implications to regulators and investors in the conclusion section.

Literature Review

The debate regarding the causal link between inward FDI and economic growth has existed for decades and has resulted in mixed conclusions from various researchers and economists. Different economists have shared different opinions about the true impact of inward FDI upon the economy of the host country; some believe that inward FDI induces growth while others are possessing contrary ideas (Nistor, 2015). An extensive review of the literature reveals the existence of several theories which help to explain the nexus between FDI and the economic health of the host country (Nawaz & Ganic, 2021). The Endogenous Growth Model postulated by Lucas in the year 1988 helps to explain the mechanism behind FDI inflows translating into economic growth of the recipient country. Also known as the Lucas Model, the theory states that FDI accelerates growth in an economy by contributing towards the development of human capital as it allows the local labor to get acquainted with the new technology.

Bhattarai (2016) also advocated the conjecture as he asserted that exposure to innovative technology and efficient managerial skills contributes to the economic development of the country in the long run. As noted above, FDI helps to bring innovation and technology into a country ultimately leading to economic growth. Subsequently, the host country is not only able to rack up on physical capital, but the inflow of FDI contributes a great deal towards developing human capital as well. The knowledge spillover effects have long-term benefits for host countries as they lead to a rise in productivity levels, technical know-how, and proficiency of the local labor when foreign investors see potential in the country's market and decide to bring in the investment (Agrawal, 2015). Gupta & Singh (2016) enriched the literature further with their study as they asserted that inward FDI boosts economic growth, particularly for BRICS economies. These emerging economies have showcased such an immense economic growth stimulated by FDI that they have managed to retain their position as a few of the most attractive countries to the foreign investors. The amount of FDI secured by BRICS economies has, thus, risen to the extent that they contribute around 21% of the global FDI inflows (Xiao & Park, 2018).

Inward FDI is largely considered as economic growth opportunity for the developing countries as they can benefit from the hands-on experience in these foreign firms and allow them to adopt and implement the efficient business practices. While the impact of such investments looks very promising for such nations but the advocates of the "Dependency Theory" argue that reliance upon these investments could prove detrimental to the economy in the long run (Alshamsi & Azam, 2015). The intuition behind the notion is the exploitation of developing countries at the hands of large multinational companies as they deliberately introduce their operations in such countries to gain the advantage of the availability of low-cost raw material and cheap labor. Zilinske (2010) also supported the inverse relationship between FDI and economic growth as he stated that the capitalistic nature of these foreign companies prevents them from fairly compensating the recipient countries of their resources. Furthermore, the impact of new factories being set up because of inward FDI in a country impedes economic growth due to their adverse impact on the environmental quality as well (Abdoui & Hammami, 2017).

The hazardous emissions like carbon dioxide not only worsens the health of labor but also hampers their productivity levels due to which the desired level of economic development is almost impossible to achieve. Several studies provide robust evidence on the negative relationship between the two variables specifically in the case of BRICS economies due to their negative impact on the environmental quality of a country. Azam (2019) studied the economic impact of FDI in Brazil from 1986 onwards and recommended that economic development cannot be achieved if environmental pollution is not kept in check. Furthermore, Kostakis, Lolos, & Sardanou (2017) analyzed the Brazilian economy using an Environmental Kuznets Curve (EKC) and noted that inward FDI leads to environmental degradation of the country which hampers the overall economic health of the country. While the vast amount of literature corroborates the existence of a nexus between the two variables under study, irrespective of whether the FDI has a growth-enhancing or a growth-retarding outcome, many researchers have propounded the absence of any such association between them.

The Neo-Classical Growth Theory put forward by Robert Solow in 1956 states that the long-term impact of FDI on the economic health of the recipient country is of trivial nature. It implies that relationship is existing only in the short run as economic growth is boosted due to the enhancement in the capital stock of the host country due to inward FDI (Varahrami & Vajari, 2019). In the long run, however, Zekarias (2016) states that the concept of diminishing returns to capital comes into play as the economy keeps advancing forward. Moreover, the inflow of foreign capital is mostly offset by the outflow of funds to the origin country in the form of remittances and profits

because of which the true benefits of FDI may not be realized by the host country to their maximum potential. Asheghian (2016) also confirmed that no causal relationship exists between the two variables. However, Duarte, Kedong, & Xuemei (2017) hint at the bidirectional relationship between them. The intuition behind such a relationship is the fact that foreign investors are inclined towards investing in a country with high GDP growth rates which automatically insinuates the fact that a country must experience significant economic growth for it to be considered as a good investment opportunity in the eyes of a foreign investor.

The non-existence of a relationship between FDI and economic growth is not necessarily true. In some cases, a unidirectional relationship exists that extends from the economic health of a country causing an increase in FDI instead of being FDI causing the economic growth. In an extensive study on the determinants of FDI among BRICS countries, Gupta & Singh (2016) observed that the economic health of Brazil, India, and China plays a major role in determining the amount of FDI they receive during the given period. The increased inward flow of foreign direct investment leads to higher levels of economic growth (Kayani, 2021). Furthermore, a piece of more robust evidence is provided by Jomit & Joseph (2018) in their study on the economy of Brazil. They noticed that the GDP helps determine the amount of FDI that flows into the country rather than FDI being determining the extent of economic growth. However, a growing strand of literature attributes the true impact of FDI in case of different sectoral studies of the receiving country. For instance, Elheddad (2016) states while FDI tends to have a positive impact on the economy when invested in the manufacturing sector, the same investment can in fact prove to be counterproductive when made in the primary sector.

Among the BRICS economies, FDI focused on the manufacturing sector mostly finds China and Brazil as its destination which can further help to explain that why the economic growth of Brazil is so positively influenced by the inflow of FDI (Prabhakar, Azam, Bakhtyar, & Ibrahim, 2015). This provides us the further justification for the contradictory opinions of various researchers regarding the direction of the relationship between FDI and economic growth. Moreover, many economists argue that achieving economic growth through increased inward FDI is not possible until a country has already reached to a certain level of economic and financial development. Agrawal (2015) asserted that the magnitude of a causal relationship between them largely depends upon the economic dynamics a country is subject to. The country-specific factors are quite incremental in determining the extent to which FDI can boost the economy of any country. Since Brazil is equipped with a unique set of factors that are not applicable to any other country, the influence exerted by FDI on its economy is not comparable to any other. A vast amount of literature along with relevant statistics have helped to establish that inward FDI results in increased GDP growth of Brazil.

Methods

In this study we are trying to gauge the relationship between Inward FDI and Economic Growth in case of emerging Brazil from Latin America. We took inward FDI as dependent variable and economic growth as independent variable. Further to measure the economic growth of Brazil, we took the variables like Gross Domestic Product per capita, employment, capital formation, and exports. We took the most recent data for all variables from World Bank Development Indicators ranging from 1996 to 2019.

The model equation is given as:

$$\ln FDI_{i,t} = \alpha + \beta \ln GDP_{i,t} + \beta EMP_{i,t} + \beta \ln CF_{i,t} + \beta Exports_{i,t} + \varepsilon_{i,t} \quad (1)$$

In equation (1), $\ln FDI$ is the natural logarithm of inward foreign direct investment, $\ln GDP$ is natural logarithm of gross domestic product, EMP is employment, $\ln CF$ is natural logarithm of capital formation. Whereas $\varepsilon_{i,t}$ denotes disturbance or error term.

Results

As a preliminary analysis, we ran the descriptive statistics, and the results report the means, standard deviation, minimum, maximum, variance, skewness, and kurtosis under Table 1. The descriptive statistics for all the variables indicate that data is normal and have no issue of outliers or missing variables. The mean value for dependent variable that is FDI is 3.236. Whereas, GDP has mean value of 2.260, employment has 4.313 and capital formation has 2.901.

Table 1. Descriptive Statistics.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Variables	Mean	Sd	Min	Max	Var	Skewness	Kurtosis
FDI	3.236	0.988	1.476	5.034	0.977	-0.289	2.193
LNGDP	2.260	2.650	-3.546	7.528	7.020	-0.268	3.114
Employment	4.313	0.314	3.470	4.850	0.0988	-0.674	3.535
LNCF	2.901	0.125	2.683	3.083	0.0156	-0.100	2.177
Exports	12.10	2.651	6.730	16.55	7.029	-0.569	2.712

Table 2. Pearson Correlation Test.

Variables	FDI	GDP	Employment	Capital Formation	Exports
FDI	1.0000				
p-value					
GDP	-0.1517	1.0000			
p-value	0.4791				
Employment	0.0316	-0.3066	1.0000		
p-value	0.8836	0.1451			
Capital Formation	0.0321	0.5029	-0.6656	1.0000	
p-value	0.8816	0.0123	0.0004		
Exports	-0.0857	0.1172	0.2916	-0.1946	1.0000
p-value	0.6907	0.5853	0.1668	0.3325	

For detecting the multicollinearity, we ran Pearson correlation test (Wu & Deng, 2020). This is a standard test for measuring the multicollinearity among the variables. In case of value range more than 0.80 we need to drop the variables. However, in case of our study, we found that there is no issue of multicollinearity as all the variables fall within the acceptable range of 0.80. The values are in line with prior studies Alipour et al. (2019).

Table 3. Results of Regression Analyses.

Variables	FDI (Ordinary Least Square Regression)	FDI (Random Effect Regression Analysis)
GDP	0.771*** (0.095)	0.873*** (0.078)
Employment	0.448 (0.925)	0.448 (0.945)
Capital formation	2.399 (1.454)	2.399 (1.173)
Exports	0.046*** (0.088)	0.763*** (0.096)
Constant	79.91 (51.12)	79.91* (41.57)
Observations	24	24
R-squared	0.373	0.54

Note: Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1

Discussion

As a main analysis, we ran regression analysis for examining the relationship between inward FDI and economic growth for the period 1996-2019. The results in Table 3, report a positive and significant relationship between foreign direct investment and economic growth. This means that with increase in inward FDI the economic growth increased in Brazil. More specifically, the 0.77% of economic growth resulted in Brazil due to inward FDI. Similarly, exports are also indicating positive relationship, this shows that increase in inward FDI, the exports of Brazil also increased by 0.046%. Whereas, in case of employment and capital formation an insignificant relationship has been observed. To check the robustness of the results we ran random effect regression for confirming the results that we obtained under Ordinary Least Square regression analysis. The results of Random Effect Regression analysis are basically complimenting the results of Ordinary Least Square Regression. The results show that GDP per capita and exports have significant and positive relationship with inward FDI. Whereas capital formation and employment have insignificant relationship with inward FDI. The results are consistent with

prior studies such as Sirag et al. (2018) and Lee and Chang (2009). As it is eminent, one of the objectives of FDI, trade and cash movement is, as per the viewpoint of host countries, to work on monetary turn of events, headway and government help. The benefits, in any case, rely especially upon the volume of adventure, yet moreover on the general financial circumstances and valuable capability. Late FDI inflows into Latin America, and especially into Brazil, have made these issues essential ones considering the way that: first, reality has transformed into a crucial concern among specialists and system makers the equivalent, due to the fundamental need to diminish present current account unpredictable qualities through extended ferocious tolls (and capable import substitution as well); second, FDI inflows may in like manner address a liberal enhancement to local save assets in financing hypothesis, given the need to assemble adventure rates for advancement resumption at a speed expected to work on friendly conditions. Above all, FDI is an essential variable to grow the contestability of business areas. Thusly, it conceivably deals with both competition and reality. This is particularly apparent, in countries like Brazil, with respect to non-tradable: banking, retail and rebate trade, insurance (clinical and other), public utilities are, all of them, regions in which extended FDI streams are being considered liable for critical viability, contention and reality gains. Additionally, the way that sum late FDI has been facilitated to non-tradable regions has positive consequences for the reality of tradable. A useful organizations region is a fundamental for a capable toll region both to the extent cash/banking, energy, broadcast interchanges similarly as transport systems and ports.

Conclusion

Foreign direct investment is considered as an important instrument to stimulate economic growth of any country (Zuzana, 2014). So, in this article, we examined the relationship between inward FDI and economic growth in case of emerging Brazil from Latin America. We took the annual time series data from World Development Indicators for the period ranging from 1996 to 2019. We applied the Ordinary Least Square Regression and Random Effect Regression Analysis for gauging the relationship between variables and for testing the robustness of the results. We found that FDI has a positive and significant relationship with per capita GDP and the exports. Whereas, FDI has insignificant relationship with the employment and capital formation. The reason could be that most of the FDI went to the service and manufacturing sectors where shedding of the labors took place because of modernization and rationalization. It is also important to mention that countries also need to have absorptive capacity to attract and absorb the FDI. Generally, the countries endowed with human capital have higher absorptive capacity. By human capital we mean the educated and the skilled labors. Human capital is considered by many researchers and studies to be the most crucial factor in the economic success (Rafaj, 2020). The concept of human capital suggests that the increase in human capital in the economy will result in an increase in aggregate productivity (Rehak, 2020).

As a future research direction, authors would like to suggest that in future the impact of Covid-19 can be examined in the relationship between FDI and economic growth. Secondly, the future recommendation for the governments is that they need to develop more human capital so that they can actively contribute to attracting FDI. The article holds an important policy implication for the other developing countries of Latin America; they need to attract good amount of inward FDI to achieve the robust economic growth and development. Particularly, the investment should be attracted in those sectors and industries which can help these countries to increase the employment opportunities for their local labors. The sole limitation of the study is that data of FDI and economic growth indicators was available only up to year 2019.

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