

Abstract

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FDI Impact on Economic Growth in Emerging Countries: The Role of Psychic Distance and Country of Origin Diversity

The current trends of globalization worldwide and the rapid innovation in information and communication technology have provided FDI a great opportunity to increasingly flow between developed and developing countries. FDI has been perceived by emerging and developing countries as a key source of economic development and rapid economic growth through bridging the gap between domestic savings and investment and bringing the latest technology and management know-how from developed countries, resulting in an increase in the productivity of domestic firms and thus achieving economic growth. Consequently, governments in developing countries started to compete for attracting as much as possible FDI, mainly through offering enormous collection of host government incentives and tax exemptions on unclear basis. Unfortunately, FDI has not proved to exert real economic gains to the host countries compared to the huge preferential incentives and tax exemptions granted. Due to the perceived importance of FDI, FDI has gained attention from researchers, and many studies investigating the impact of FDI on the host economy have been conducted however, there have been long debates and controversies regarding FDI effect. Researchers have argued that for the host country to reap the expected benefits from FDI certain factors must be prevailing in the economy. Some of the factors that have been stated are the absorptive and technological capacity of the host country, financial market development, the human capital of the host country and the psychic distance between home and host countries. Using the data collected for six host emerging countries over the period 2003-2012, while employing an OLS regression model, this research intends to provide better understanding of the effect of FDI on the economic growth in emerging countries, while investigating the effect of both the psychic distance between home and host countries and the diversity of FDI country origin. Results have revealed that FDI will only have a positive effect on the economic growth of these countries, if they originate from a politically different country, from a home country that has a similar educational level. It has also been concluded that FDI can positively affect the host economy if FDI flows capture a high proportion of the total FDI in the host country.