Economic impacts of FDI inflows: A literature review*

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Received: 21/03/2019 Accepted: 20/04/2019
Online Published: 29/04/2019

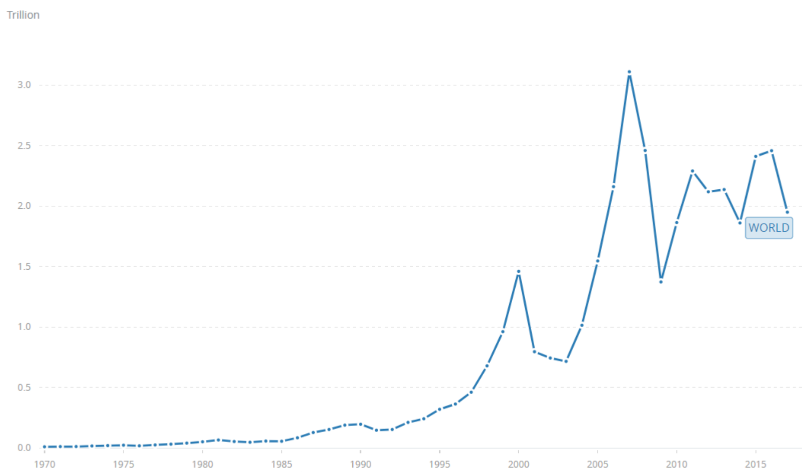
Abstract
FDI inflows have been raised considerably during the past four decades and had many economic, social, and institutional effects in all the countries. This study researched the relevant empirical literature on the economic effects of FDI inflows in various countries. We revealed that FDI inflows had significant effect on economic growth, unemployment, financial sector development, tax revenues, and environment.

Keywords: FDI inflows, macroeconomic variables
JEL Classification: F21, F43

1. Introduction

FDI inflows have been increased significantly as of 1970 together with the accelerating liberalization and globalization process in the world and reached to 1.95 trillion dollars in 2017 from 10.172 billion dollars in 1970, but experienced fluctuations mainly resulting from the economic crises as seen in Chart 1.

Chart 1: Foreign direct investment, net inflows (BoP, current US$)



Source: World Bank, 2019

* This study was derived from the master thesis entitled "Impact of Greenfield and Brownfield Investments on the Unemployment: Transition Economies of Central and Eastern European Union" of Ayse Gul Ozogul under the advisory of Assoc.Prof. Yilmaz Bayar.

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The relevant literature on the economic effects of FDI inflows has revealed that FDI inflows may affect the economic growth, savings, competitiveness, unemployment, tax revenues, financial sector development, technological development, and environment. In this paper, we will analyze the empirical literature on the economic effects of FDI inflows in the coming section, and then summarize the key findings.

2. Literature on Economic Impacts of FDI Inflows

FDI inflows can affect many economic variables. First FDI inflows can affect the economic growth through savings, human and physical capital, technology, and development of financial sector. In this context, FDI inflows can enhance the economic growth through increasing the human and physical capital accumulation, raising the human capital through know-how transfer and learning by doing, technology transfer, and financial sector development (Neuhaus, 2006; Anwar and Nguyen, 2010). Furthermore, most of the empirical studies have reached that FDI inflows positively affect the economic growth (e.g. see Yucel, 2014; Bhattarai, 2016).

Secondly FDI inflows can affect the unemployment through raising the economic growth. However, FDI inflows enhancing the technological development or brownfield FDI inflows may raise the unemployment. The relevant empirical literature has reached mixed findings about the nexus between FDI inflows and unemployment (Zeb et al., 2014; Bayar, 2014; Kurtovic et al., 2015; Djambaska and Lozanoska, 2015)

FDI inflows can affect the total tax revenues positively indirectly through enhancing the economic growth and employment (Grop and Costial, 2000). However, FDI inflows may affect the total tax revenues negatively in case tax reductions, legal privileges in the transfer of income and fiscal incentives such as free land allocation and supports for the labor costs are provided to attract FDIs (Bayar ve Ozturk, 2017). So, the net influence of FDI inflows on the total tax revenues is ambiguous. The empirical literature on the effect of FDI inflows on tax revenues generally has revealed that FDI inflows positively affected the total tax revenues (e.g. see Mahmood and Chaudhary, 2013; Bunescu and Comaniciu, 2014).

FDI inflows also can influence financial sector development positively through enhancing the funds in financial system, but FDI inflows may have no or negative impact on financial sector development, because FDI inflows are also an alternative financing instrument (e.g., Desbordes and Wei, 2014). The relevan empirical literature has revealed that FDI inflows have made significant contribution to the development of financial sector (e.g., see Abzari et al., 2011; Gebrehiwot et al., 2016).

Some scholars have researched the impact of FDI inflows on the environmental degradation. The studies (e.g. Acharyya, 2009; Mahmood and Chaudhary, 2012; Blanco et al., 2013; and Neelakanta et al., 2014) generally have revealed that FDI inflows negatively affected the environment. However, the limited number of studies (e.g. Shaari et al., 2014) have discovered no significant relationship between environment and FDI inflows.

FDI inflows may affect the technological development through backward and forward linkages, competitive effect, demonstration effect, human capital formation and knowledge dissemination (Berger and Diez, 2008). The relevant empirical literature has veriefied the theoretical considerations (e.g. see Sinani and Klaus, 2004;)

3. Conclusions

The FDI inflows have been raised considerably in the recent years and led many economic, social, and institutional effects. This study investigates the relevant empirical literature on the economic effects of FDI inflows and revealed that FDI inflows had desired or undesired impact on the economic variables of economic growth, savings, competitiveness, unemployment, tax revenues, financial sector development, technological development, and evironment.

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