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Foreign Direct Investment Inflows and Economic Growth: When Would Tiger Slay Lion?

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ABSTRACT

This study is motivated by the IMF`s projection about the GDP of the leading economy among the Asian Tigers overtaking the century dominating lion`s comes 2030. Meanwhile, past empirical studies have shown divergent views on principal determinants of FDI inflows in the USA and Chinese economies. However, in achieving the objective of this study, the authors employed the OLS modeling to investigate the link between FDI, GDP, GDP per capita growth and growth rate of economy of the US and China from 2002 to 2017. The findings from this study show that the principal determinant of FDI inflows in the USA is GDP. On the other hand, GDP per capita growth is the principal determinant of FDI inflows in China. Therefore, the study concludes as projected by the International Monetary Fund that the China`s GDP will overtake the America`s comes 2030. There is a direct link between FDI inflows and GDP, therefore, from 2030 the Chinese economy will be the first destination of FDI inflows in the world. However, it could be advocated as a recommendation that: the policy makers in the United States of America should as a matter of urgency embark on policy measures that will catalyze exponential expansion of the country`s market size. If the market size of the US could be expanded exponentially, it will extend the China`s FDI inflows and GDP convergence beyond 2030. Similarly, all hands must be on deck by the policy makers in China to embark on policy measures that will sustain China`s GDP per capita growth in the economy. As long as this variable grows on a sustainable basis, China will be an indomitable gladiator in the arena of global FDI recipient in the nearest future.

Keywords: FDI Inflows, Economic Growth, Tiger, Lion, China and USA.

INTRODUCTION:

In the last five decades, the important role in which foreign direct investment has occupied in integrating the world economy cannot be overemphasized. Some four decades ago, the advanced capitalist economy like the United States of America, the United Kingdom, Canada, France, Germany, Italy and Japan were the popular competing gladiators in the arena of FDI inflows and outflows. The data from UNCTAD investment report shows that United States of America is the champion of the world with the estimated US$3,925 billion of FDI inflows from 1970 to 2014. Meanwhile, the United Kingdom occupied the second position with the accumulated US$1,698 billion and China the third position with calculated US$1,605 billion within the same period simultaneously. (UNCTAD, 2015).

Similarly, it is paramount to note that in the last four decades the United States of America, the United Kingdom and Germany concurrently registered US$4,875 billion, US$2,089 billion US$1,484 billion as FDI outflows to the rest of the world. (UNCTAD, 2015). This attests to the strategic position in which these economies occupy in the global economy.

Meanwhile, with the emergence of BRICS block in the last decade, China has not only been a destination of FDI inflows but also a major player in FDI outflows in all regions of the world. In 2017, despite the fact that the United States of America claimed the lion`s share of global FDI inflows, China overtook the United Kingdom with the US$144 billion. On regional basis, the world witnessed a paradigm shift concerning destination of FDI inflows. The Asia became the champion of arena, while the European Union and North America were simultaneously coming behind the newly crowned region of the world attraction. (UNCTAD, 2018).

However, the United States of America and China are the largest developed and developing countries respectively. These countries exert key important economic and political roles in the globe. Though China is not a member of G7 but an emerging economy. It is likely that it might not currently possess the political influence of the United States of America in terms of territorial extension and affiliation but its population size which serves a huge potential consumer market characterized with larger middle-income group, well developed financial system, improved communication network, efficient energy and transport system, continuous infrastructural development alongside with effective distribution of goods and services might serve as a competitive advantage for this most populous Nation of the world.

Over time, there have been several studies concerning factors that propel FDI inflows in both developed and developing economies. Literature has identified factors like openness of the economy, exchange rate, past FDI inflows, level of technology, inflation rate, cost of labour, market size, and growth rate of the economy among others as the determinants of FDI inflows. Meanwhile, in the recent time, controversy has surrounded the results and policy recommendations about the determinants of FDI inflows in the United States of America and China. See (Loree and Guisinger 1995), (Xing 2006), (Galina and Long 2007), (Cheung and Xin 2004). In order to clear the controversy and update the existing literature, this study moves the frontier of knowledge by establishing the major determinants of FDI inflows in the US and Chinese economies concurrently.

REVIEW OF LITERATURE :

Theoretical Literature Review:

It is important to recall that the pioneering research work of (Dunning, 1973 & 1981) which provided a classical model of determinants of FDI. His popular OLI paradigm identified ownership, internationalization and location as indispensable variables that determine the flow of foreign direct investment in the economy.

Empirical Literature Review:

This section provides a panoramic view of literature reviews of various factors which determine FDI inflows in the United States of America and China in particular and the rest of the world in general.

(Loree and Guisinger 1995) conduct a study about the determining factors of FDI inflows in United States of America from period of 1977 to 1982. The authors conclude that the policy of host economy and infrastructure are significant factors that determine the FDI inflows in the economy. Meanwhile, (Sahoo 2006) uses panel co-integration test, to establish that FDI inflows in South Asian countries is as a result of the market size, the growth of labour force, infrastructure index, and openness of economies.

In the same vein, (Sing and Jun 1995) adopts a qualitative economic variables to establish a direct relationship between taxes payment on international transactions and flows of FDI to developing economies. Meanwhile, (Nunes et al 2006) confirm that find that the degree of openness of the economy, size of the economy, infrastructural facilities, macroeconomic stability, wages, human capital and natural resource endowment determine FDI flows between the periods of 1991 to 1998. Similarly, (Duran 1999) adopts Panel data alongside with time series techniques to discover the principal drivers of FDI inflows in 1970-1995. The author concludes that the principal determinants of FDI inflows are domestic savings, the size, macroeconomic stability, growth, trade openness and country's solvency.

Consequently, while examining the determinants of FDI inflows in some selected East and South Asian nations during the period of 1960 to1987 adopting a model of traditional derived-factor of a multiple product monopolist, (Lucas 1993) argues that the determinants of FDI inflows show higher degree of responsiveness to aggregate demand of exports than domestic and similarly higher degree of responsiveness to interest rate than wages.

However, Aguilar and Vallejo (2002) examine the driving force behind the bilateral FDI orchestrated by the regional integration agreement in Latin America. The researchers employ gravity model, and consequently

establish that both development of domestic and foreign economies, common language existence and the size of the economies are the principal determinants of FDI inflows in this region.

In the same vein, Asiedu (2006), critically examines the contribution of infrastructural development, natural resources, human capital, market size, host countries' investment policies, reliability of legal system and stability of political climate on FDI flows. The author uses fixed effect panel model to address the objectives of the study and subsequently the finding from the study shows that all variables of interest promote FDI apart from corruption, political instability which prove otherwise.

Meanwhile, (Asiedu and Lien 2011) utilize GMM estimator; and regression analysis to address the link between democracy and FDI, and if natural resource endowment affects the relationship on host countries. The authors submit that democracy would promote FDI if only and only if the percentage of oil and minerals in the total exports of the country is less than its critical value.

Also, (Ojo and Alege 2010) pooled data from 27 economies in Sub Saharan Africa with a view to estimating the impact of global financial crisis, policy implications on sudden rise on FDI flows, and financial and economic development. The results from panel Vector Autoregression model employed for the study indicate that continuous rise in economic activities will stimulate inflow of FDI in Africa.

UNACA (2009) examines the major factors that determine net FDI inflows in Africa with the aid of a panel data of 31 countries for 26 years starting from 1984-2009. The study confirms the following as the key determinants: religious tension risk, share of oil in exports, size of market, past foreign direct investment inflows, level of corruption and domestic credit

Similarly, (Chakarabarti 2001) critically evaluates the principal determinants of FDI in 31 African economies with the use of econometric techniques and a range of robustness/sensitivity analysis. It was discovered from the findings of the work that both natural resource and market factors are the key determining factors of FDI inflow to Africa.

Moreover, (Akinlo 2003) examines the impact of FDI in Africa while pooling annual data from twelve African nations. The author submits that FDI affects growth primarily via capital accumulation, as contrary to increasing productivity.

Consequently, Ogun, Egwaikkhide and Ogunleye (2012) investigate the nexus between FDI and real exchange rate in some selected Sub-Saharan Africa (SSA) economies with the Granger causality and simultaneous estimation approaches. The causality tests show statistical dependence between real exchange rate movements and FDI for a few of the economies. But, the regression analysis shows a statistically significant linkage between the variables used. The authors generally conclude that FDI flows are sensitive to real exchange rate movements in Sub-Saharan Africa.

Also, (Nyamrunda 2012) adopts the Augmented Dickey Fuller test (ADF), Vector error Correction Model (ECM) and the Johansen`s cointegration to analyse the stochastic trends of the exchange rate and the net FDI inflows into less developed countries mainly Tanzania for the period 1960 to 2011. The paper discovers a significant long-run relationship between the exchange rate of Tanzanian shilling and net FDI inflow.

Moreover, (Saibu and Akinbobola 2014) use vector error correction modeling (VECM) approach for investigating the relationship among globalization, FDI and economic growth in selected Sub Saharan African countries. The author posit that trade liberalization has not significantly impaired economic growth process of the SSA countries, and also the upsurge in the capital flows to African economies was not sufficient to insulate the African economies from the global economic shocks. It was concluded from the paper that fluctuations in real economic growth in the Sub Saharan African nations might be beyond the external shocks from capital inflows and trade inflows.

However, while using the OLS analytical frame work to analyze the nexus between FDI, domestic investment and economic growth in SSA between the period of 1990 and 2003, (Adams 2009) discovers that FDI is positively and significantly correlated with economic growth meanwhile the result shows a negative relationship when the country specific effects are controlled for.

Conversely, (Gui-Diby 2014) employs GMM technique to critically examine the nexus between FDI and economic growth for 50 African nations for 1980-1994. The author discovers a negative relationship between the two variables over the period 1980-1994, but a positive relationship was discovered between 1995 and 2009. The author attributes the positive impact in the latter period to the substantial improvement of the business climate and multiplier effect of the resource-based sectors via exporting.

In conclusion, from the empirical literature reviewed, there was no consensus regarding the factors that determine the FDI inflows. Hence, the relevance of this study.

An Overview of Potential Variables Determining FDI Inflows Visavis USA and Chinese Economies:
The following have been identified in the literature as factors that have the capacity to drive the performance of FDI inflows in both developed and developing countries.

Market size :
The larger the market the higher the flows of FDI while the reverse is the case of smaller market. The USA is the largest economy in the world with estimated GDP of US$19.39 trillion in 2017 (WBI, 2018). The United States of America`s economy has been the largest economy close to a century. Meanwhile, China is the second biggest economy of the world with the estimated GDP of US$ 23.45 trillion in 2017. (WBI, 2018).
However, another important variable that should not be undermined while looking at the market size is the population of a country. China has the largest population in the world with approximated 1.38 billion people. This constitutes a huge potential consumer market for the country. On the other hand, the United States of America has estimated population of 325.7 million which is ranked third in the population of the globe.

Stability of Economy:

Stability of the economy reduces the uncertainty condition of the economy. It has been established that am economy with a relatively stable macroeconomic variable such as inflation and exchange rates will attract more FDI inflows than an economy with a more volatile macroeconomic variables. The inflation rate has been stable in the US for the past two decades with annual average rate of 3.38% in 2000 and 2.13% in 2017 (USIC, 2018). Meanwhile, the Chinese`s economy witnessed its highest peak inflation rate of 28.4% in February of 1989 and recorded its lowest rate -2.20% in 1999, ten years. The Chinese's inflation rate has been stable in the past decade with 2.30 % in August, 2018. (NBSC, 2018).

Cost of Labour:
The cost of labour is one the principal determinants of location of multinational companies in the host countries. The higher labour cost will invariably bring about higher cost of production, this can in turn and limit the FDI inflows. As such one expects that inverse and significant nexus should exist between cost of labour and FDI inflows. The average wage per hour in manufacturing industries in the US is $US23 in 1997 and $US100 in 2016. Conversely, the huge population of China is a contributory factors that makes wages to be very cheap in the country. Average wage per hour in the manufacturing sector is $US3.6 in 2017.

Infrastructural Facilities:
The availability of well-developed and functional infrastructures is a major determinant of FDI inflows. As a result of this, one expects that infrastructures will propel flow of foreign capital into the host economy. As a matter of fact, the United State of America and China have one of the best modern infrastructural facilities in the world, such as good road network, uninterrupted electricity supply, modern system telecommunication system, water waves and host of others. The infrastructures are undeniable engine rooms for the manufacturing sector to thrive in any economy.

Trade Openness:
The degree of openness of economy plays a critical role in country FDI inflows. Larger quantum of FDI inflows is geared towards exports. Before recent trade war initiated by the Trump led administration, the United States of America is a free trade zone. However, recent increment in tariff on exports from China and European countries shows that the US economy may become rapidly closed to trade with the rest of the world soon. It is interesting to state here that US-China trade relationship directly and indirectly accounts for over 2.5 million jobs in United States of America`s industries. China was America`s 11th largest export market in 2000. But the country has grown to be the third largest market for American goods and services with the creation of estimated 1.8 million jobs and $US165 billion dollars of GDP in the US economy in 2017. On the other hand, China started to reform its economic system around 1970s, and eventually joined world trade organization in 2001. It took approximately 22 years for the Chinese to be fully opened to the global market. As part of China economy policy to open its economy through international trade, the country started signing Currency Swap Agreement in 2009 with some South East Asian countries, Argentina, Brazil, Canada, the United Kingdom, and of recent Nigeria.

Growth Rate:
The annual growth rate of economy is a critical factor determining the flows of FDI in the recent time. The

estimated average growth rate in the US in the last 10 years is 3.5%. Meanwhile, the estimated average growth rate in china in the last 10 years is 8.8%. Chinese economy is the fastest growing economy in the world.
In summary, critically looking at the relative performances of the above variables in the US and Chinese economies, the huge market size and low labour cost in China as a result of its teeming population, faster growing rate of the economy and current trade partnership with the African economies especially and rest of the world in which the Chinese government embarked upon will put China at competitive advantage over the US in attracting further FDI inflows in the nearest future. Similarly, as International Monetary Fund projected that the Chinese GDP would override the America`s comes 2030 as a result of its aggression in the rate at which the economy is growing in the past decade. With the flash poem of trade war in which Trump led government is chanting to China and European countries, it is not a gainsaying that China may equally be the first FDI inflows destination in the world comes 2030 as well.

METHODOLOGY:

This study makes use of secondary data from 2002 to 2017, a year after China joined WTO. The data on GDP, growth rate and investment per capita of the United States of America and China were extracted from World Bank Indicator. In the same vein, data on FDI inflows were sourced from UNCTAD database published by World Bank. OLS modeling was estimated using E-Views software.

Model Specification:

The model for this study can be specified in the general form as follows:

$FDI = F(GDP, Grt, Infl, InvP)$ ……..…….. 1

If model 1 linearized, it gives us model 2

$LnFDI_t = \beta_0 + \beta_1 LnGDP_t + \beta_2 Grt_t + \beta_3 Infl_t + \beta_4 InvP_t + Ut$ …… (2)

Where FDI denotes net FDI inflows into the host countries, INFL= Inflation rate, GDP serves as a proxy for the market size of the economy meanwhile, Grt represents the growth of the country, InvP means investment per capita, U connotes error time and t ranges from 2002 to 2017.

By estimating model (2), the values of the coefficients of $\beta_1, \beta_2, \beta_3$ and β_4 will serve as the determinants of FDI inflows in the countries under consideration.

RESULTS AND DISCUSSION :

Table 1: Descriptive Statistics of USA Annual Data Series (1990-2017)

Descriptive Statistics	LFDI	LRGDP	GDP GROWT RATE	GDP/CAPITA
Mean	2.21E+11	1.52E+13	1.900000	1.043750
Median	2.02E+11	1.50E+13	2.250000	1.500000
Maximum	4.66E+11	1.73E+13	3.800000	2.800000
Minimum	5.31E+10	1.31E+13	-2.800000	-3.600000
Std. Deviation	1.17E+11	1.20E+12	1.556920	1.538817
Skewness	0.773743	0.079301	-1.862329	-1.901173
Kurtosis	3.100638	2.332869	6.423626	6.415313
Jargue-Bera	1.603225	0.313479	17.06286	17.41479
Probability	0.448605	0.854927	0.000197	0.000165
Sum	3.54E+12	2.43E+14	30.40000	16.70000
Sum. Sq. Deviation	2.07E+23	2.16E+25	36.36000	35.51937
Observation	16	16	16	16

Source: Author`s Computation 2018

Table 2: Descriptive Statistics of Chinese Annual Data Series (1990-2017)

Descriptive Statistics	LFDI	LRGDP	GDP GROWT RATE	GDP/CAPITA
Mean	1.01E+11	4.65E+13	9.387500	8.837500
Median	1.12E+11	4.49E+13	9.450000	8.950000
Maximum	1.36E+11	7.86E+13	14.20000	13.60000
Minimum	5.27E+10	2.05E+13	6.700000	6.100000

Descriptive Statistics	LFDI	LRGDP	GDP GROWT RATE	GDP/CAPITA
Std. Deviation	3.07E+10	1.90E+13	2.151240	2.160517
Skewness	-0.385533	0.197377	0.634581	0.595821
Kurtosis	1.604638	1.765492	2.771648	2.652347
Jargue-Bera	1.694386	1.119894	1.108612	1.027250
Probability	0.428616	0.571239	0.574471	0.598323
Sum	1.62E+12	7.44E+14	150.2000	141.4000
Sum. Sq. Deviation	1.41E+22	5.39E+27	69.41750	70.01750
Observation	16	16	16	16

Source: Author`s Computation 2018

Tables 1 and 2 above show the descriptive statistics of the annual data series of FDI inflows, economic growth, growth rate of economy, GDP per capita growth of the United States of America and Chinese economies used in this analysis. The descriptive statistics of the data series provide information about the distribution of the sample series. The values of mean, median, minimum and maximum are very close. For a distribution to be perfect symmetrical; mean, median and mode must converge. See (Karmel and Polasek 1980). In a situation of near symmetry, mean, median and modal values should be very close to one another. From the above table, it is observed that the values of mean and median of the data set are very close which confirm the existence of symmetrical nature of the probability distribution of data and the thickness of their tails of these distributions respectively. Meanwhile, it is important to note that these two statistics tests are very important as they are usually used for computing Jargue-Bera statistics and as well for testing the normality or asymptotic properties of a particular series.

However, analyses in econometrics are often based on normality and asymptotic assumptions of properties of data employed. From the distribution of data shown in table 1 and 2, this suggests that all annual data used to proxed the study variables are normally distributed.

Table 3: Dependent Variable: LFDI

Variable	Coefficient		t-statistics		P-value	
LRGDP	0.098*	0.0016**	4.9*	1.3**	0.0003*	0.2173**
Growth rate	3.980*	-2.4400**	1.6*	-1.4**	0.1167*	0.1611**
GDP/capital	-4.070*	2.5100**	-1.7*	2.5**	0.1135*	0.0085**
C	-1.610*	3.5500**	-3.7*	1 .3**	0.0042*	0.2173**
R-Squared	0.697*	0.9273**				
Adjusted R-Squared	0.621*	0.9091**				
Durbin-Watson stat	2.367*	1.5144**				

***USA ** CHINA**

Source: Authors` computation (2018)

The following variables: market size, the growth rate of economy, GDP per capita growth are identified as factor affecting the FDI inflows in the United States of America and China. From table 3, it could be deduced that the market size and growth rate of economy of the United States of America has a positive impact in attracting FDI into the economy, though the impact of market size is significant while that of growth rate is not significant at 5% level of significance. This corroborates with the assertion of Aguilar and Vallejo (2002) and Nunes et al (2006), despite the variation in methodology adopted. In contrast, GDP per capital growth shows inverse relationship with FDI inflows in the country, though not statistical significant at 5% level of significance. Also, the independent variables or regressors of the model which are market size, growth rate of economy and GDP per capita jointly explained approximated 70% of the systematic variations in the dependent variable, FDI inflows, leaving 30% unexplained as a result of random chance. However, while adjusting for the loss in the degree of freedom, the independent power declines to approximated 62%.

Similarly, both market size and GDP per capita growth show positive impact on FDI inflows in the Chinese economy. Though it is only GDP per capita growth that shows significant impact on the Chinese economy. This finding is line with the submission of (Duran 1999), (Tan *et al.* 2004) and (Sahoo 2006) in spite of fact that different methodologies were employed. On the other hand, the growth rate of the economy shows inverse relationship with the FDI inflows in China, though not statistically significant at 5% level of significance. In the

same vein, the independent variables or regressors of the model which are market size, growth rate of economy and GDP per capita jointly explained approximated 93% of the systematic variations in the dependent variable, FDI inflows, leaving 7% unexplained as a result of random chance. However, while adjusting for the loss in the degree of freedom, the independent power declines to approximated 90%.

CONCLUSION AND RECOMMENDATIONS:

This study has been carried out to critically and empirically examine the principal drivers of FDI inflows in the United States of America and China simultaneously from 2002, a year after China joined the World Trade Organization to 2017. From the results that emerged from the analysis of this study, the following summary can be drawn: The large market size of the United States of America is the principal determinant of FDI inflows in the country. The country has the largest economy in the world, this has been the major reason while the US economy has been highest recipient of FDI inflows among the committee of nations in the world. Holding all other factors constant, as long as the US economy is largest in the world, it will continue to be the major destination of FDI inflows in the global economy. Similarly, the GDP per capita growth is principal determinant of FDI inflows in China. As long as this variable is sustained the Chinese economy will continue to attract FDI inflows. As projected by the International Monetary Fund that the China`s GDP will overtake the America`s comes 2030. There is a direct link with FDI inflows and GDP, therefore, from 2030 the Chinese economy will be the first destination of FDI inflows in the world.

However, it could be advocated as a recommendation due to the findings that have emerged in this study that: the policy makers in the United States as a matter of urgency, to embark on policy measures that will catalyze exponential expansion of the country`s market size. If the market size of the US could be expanded exponentially, it will extend the China`s FDI inflows and GDP convergence beyond 2030. Similarly, all hands must be on deck by the policy makers in China to embark on policy measures that will sustain China`s GDP per capita growth in the economy. As long as this variable grows on a sustainable basis, China will be an indomitable gladiator in the arena of global FDI recipient in the nearest future.

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