Foreign Direct Investment and Growth in BRICS Countries: A Review

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Abstract: ***It is not possible for developing countries like BRICS to grow without sufficient import of foreign capital because of the gaps exist in domestic savings and requirements. For the developed countries, it is necessary to support sustainable development and for the developing countries it is used to increase economic growth. Since 1980 both developing and developed countries have been trying to attract Foreign Direct Investment through providing incentives by adopting greater deregulation of policies, best infrastructure and reliance on market forces in the economies.The main intend of this paper is to investigate the impact of foreign direct investment on growth of BRICS countries and potential determinants of FDI in these countries through literature and which of determinants are much effective to boost FDI and growth in these countries.***

Keywords: Foreign Direct Investment, BRICS, Growth

1. Introduction

BRICS is an association of five major emerging economies i.e Brazil, Russia, India, China and South Africa was coined by Jim O'Neill in 2001. The group was originally known as "BRIC" before the inclusion of South Africa in 2010. All members are developing or newly industrialized countries but they are distinguished by their large, fast-growing economies and significant influence on regional and global affairs. All five are G-20 members and these nations have met annually at formal summits. BRICS nations have a combined nominal GDP of US $ 16.039 trillion, equivalent to approximately 20% of the gross world product and estimated US $ 4 trillion in combined foreign reserves. Due to such emerging factors Brazil, Russia, India, China and South Africa have emerged as a major destination for Foreign Direct Investment (FDI) inflows.

It has emerged that the economic growth requires a greater role of the foreign direct investment. Foreign Direct Investment states as an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor. The investment is direct because the investor which could be a foreign person, company or group of entities is seeking to control, to manage or have significant influence over the foreign enterprise as per International Monetary Fund. Since 1980 both developed and developing countries have been trying to attract Foreign Direct Investment through providing incentives by adopting greater deregulation of policies and reliance on market forces in the economies. So, it is not possible for developing countries like BRICS to grow without sufficient import of capital because of the gaps exist in domestic savings and capital requirements

2. Review of Literature

The foreign direct investment has an enormous role to affect the economic growth of an economy positively and negatively. A large number of studies have proven empirically the constructive and the destructive impact of foreign inflows on economic growth. Most of these studies have studied the relationship between Foreign Direct Investment and economic growth.

Balasubramanyam (1996) used cross sectional data for 46 countries for the period 1970 to 85 for analyzing the relationship between economic growth and FDI. Study results show that FDI has a positive impact on economic growth of those countries which have followed inward looking development strategies.

Chitre (1996) International capital flows is now widely perceived as an important source for expediting the industrial development of developing economies in view of the fact that it flows as a bundle of technology, capital, skills and sometimes as the market access.

Charkovic and Levine (1998) used both panel and cross sectional data for 72 developing and developed countries for the period 1960 to 95 for analyzing the relationship between FDI and economic growth. They employ GMM and OLS methods of estimation and fail to find the evidence of the relationship between FDI and economic growth.

Johnson (2006) used panel and cross section data of 90 countries and concludes that due to technology spillovers FDI increases economic growth in developing economics but not in developed economies. The study also examines the impact of FDI on economic growth in primary manufacturing and services sectors and Alfaro (2003) is of opinion that the benefits of foreign investment vary across sectors and the impact of FDI on primary sector is negative and its impact on manufacturing and services sectors is positive and ambiguous.

Nuzhat Falki (2009) used data from 1980 to 2006 and examined the Impact of FDI on Economic Growth of Pakistan. She collected the data of FDI from the Handbook of Pakistan Economy-2005 published by the State of Pakistan and the World Bank Development indicators-2008 on variables as domestic capital, foreign owned capital and labor force. With the help of endogenous growth theory and regression analysis she concluded that FDI has the negative statically insignificant relationship between GDP and FDI inflows in Pakistan.

Pradhan (2011) study the determinant of FDI in BRICS countries over the period 1980 to 2010. Zafar (2013) examines the impact of a variety of factors market size, trade openness and cost of capital among others on FDI inflows into India, Pakistan and Bangladesh by using time series data over the period 1991 to 2010. These both studies conclude that there is a strong and positive relationship between FDI flows and economic growth in these countries.

Chakraborty & Nunnen Kamp (2006) analyzed the effect of foreign direct investment and economic reforms in India. The study used Granger Causality and panel co integration approach. The results showed that the growth effects of FDI vary widely across different sectors. There was no casual relationship found in the primary sector. While only a transitory effect of FDI on output was found in the service sector. These differences in FDI growth relation suggest that FDI is unlikely to make wonders in India if only remaining regulations are relaxed and still more industries are opened up.

Fortanier (2007) studied the role of the investor country in the event of foreign investment and growth. A panel data comprising of six major investor and 71 host countries for the period of 1989- 2002 was used. The results showed that the growth consequence of FDI differs by country of origin, and the effect on the origin country also varies depending upon the host country characteristics.

Tiwari & Mutascu (2011) analyzed the relationship between economic growth and FDI for Asian countries using Panel data approach. The sample period for this purpose comprises 1986 to 2008 and it included data of 23 countries, it was concluded from the study that both foreign direct investment and exports enhances the growth process. In addition labor and capital also play a significant role in economic growth.

Hong and Chen (2001) used time series data and panel data to analyze the determinants of FDI in China and concluded that monopolistic advantage of technology and management experience of foreign investor along with low labour cost and big market potential might be important factors attracting FDI in China.

Vu et al. (2006) analyzed that FDI in China had a positive effect directly and indirectly with its interaction with labor on growth in the industrial sector. Other sectors gained very little growth benefit from sector specific FDI. Time series data used for this study in between 1985 to 2004.

Broadman and Recanatini (2001) analyzed market size, climate, education level and local investment variables to explain the regional FDI and total FDI in Russia for the period between 1995 to 1999. Cost of labour, transportation and Infrastructure were other explanatory variables and they have significant impact on FDI.

So, we observe that several studies have analyzed the relationship of FDI as a foreign inflow variable with various macro economic factors rather than other sources of foreign capital in BRICS countries i.e. Foreign Portfolio Investment, External Commercial Borrowings and NRI deposits. Therefore, a new model formulation is to require the investigation on various sources of foreign capital and its effect on growth of BRICS countries and potential determinants of FDI have been described in the next section.

Potential Determinants of Foreign Direct Investment

Macro economic variables have an enormous role to affect the flow of FDI to a foreign country. As per literature various determinants of foreign direct investment to BRICS countries have been emerged from various studies.

Market size

Market size is generally measured by Gross Domestic Product, size of the middle class population and GDP per capita income. Larger market size countries always receive more foreign inflows than that of smaller countries having the lesser market size. It has been analyzed by various studies that FDI effects GDP of a country positively and a significant determinant of foreign investment in such countries.

Economic stability and growth

A country which has a volatile macroeconomic condition always receives less foreign inflows as compared to high and sustained growth rates economies which always receives more foreign inflows. Investors prefer always to invest in more stable economies that reflect a lesser degree of risk and uncertainty. Therefore, it is expected that Industrial production index, growth rate of GDP and Interest rates would influence FDI flows positively.

Labour cost

Higher labour cost would results production cost higher and limit the FDI inflows. There are few studies which find labour force determines FDI flows positively. Therefore, labour cost and compensation to employees also effects the inflow of FDI in these countries either positive or negative.

Infrastructure

A quality infrastructure is an important determinant of foreign inflows *(Broadman and Recanatini, 2001)* On the other hand, a country which has the opportunity to attract FDI flows will stimulate a country to equip with good Infrastructure facilities. The availability of quality Infrastructure is considered by adding Water, Transportation, Electricity and Telecommunications. BRICS countries government must focus on expenditure of capital to acquire fixed capital assets, intangible assets, land and non-financial and non- military assets for infrastructure.

Openness in Trade

Trade openness is considered to be a key determinant of FDI as represented in much of previous studies. Export oriented countries also require the import of complementary, intermediate and capital goods. In another case volume of trade is enhanced and thus trade openness is generally expected to be a positive and significant factor of Foreign Investment *(Tiwari & Mutascu,2011).*

Gross capital formation

As per Libor study higher Gross capital formation leads to greater economic growth. As a result of development in the climate of investment which further helps to attract higher FDI inflows and found little evidence of FDI having an impact on capital formation in developed countries which observed that the most important aspect of FDI in the countries is related to the change in ownership.

Valuation of Currency

The strength of a currency is the exchange rate,i.e., devaluation of a currency would result in reduced the risk of exchange rate. When a currency depreciates, the purchasing power of the investors in foreign currency terms is enhanced therefore, is expected a positive and significant relationship between the currency value and FDI inflows. The value of a currency can be controlled by the Real Exchange Rate, Real Effective Exchange Rate (REER) and Nominal Effective Exchange Rate (NEER) and counted in the origins of a country.

Therefore, above mentioned variables are effective or much considered variables of any study related to Foreign Investment to a particular country or BRICS. All these countries have the common characteristic of faster economic growth, big land size, large population and consumer market, etc. On the basis of which they are able to attract larger amount of investors around the world.

3. Conclusion

We cannot imagine about faster economic growth without knowing the trends and behavior of foreign capital flows in BRICS countries. Economic growth requires a greater role of the foreign direct investment to overcome the gaps exist in domestic savings and capital requirements. It has emerged that other sources of foreign capital like Foreign Portfolio Investment, External Commercial Borrowings and NRI Deposits also need to consider in further model formulation to check the effect of these on the growth of BRICS countries. Labour cost, Trade openness, Gross capital formation, Economic stability, Growth and Infrastructure are the main determinants and have significant related to foreign investment except the study of Charkovic and Nuzhat Falki. Except for Johnson's study, which show foreign direct investment does not make an impact on developed nations, all studies support the view that FDI has an impact on the growth of all types of economies. BRICS countries appear to as prosperity of economic and social development in the forthcoming decades. If these countries take much initiative towards bilateral trade and to form a formal union like ASEAN, G6, European Union and G8 can pool their resources as per requirement and throw competition and challenges towards the developed countries. On the basis of this, will be able to attract larger amount of investors around the world.

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