

Emerging Markets Queries in Finance and Business

The Impact of the Recent Global Crisis on Foreign Direct Investment. Evidence from Central and Eastern European Countries

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Abstract

Few studies have investigated the relationship between the recent global financial and economic crisis and FDI flows. This paper aims to analyze such a relationship for Central and Eastern European countries (EU members). The crisis had a major impact on capital flows to the region, although the magnitude of the impact differed notably, depending on the type of capital inflows and the receiving country. In order to highlight this, we use a regression model and panel data methodology, trying to find if there is some difference between the analyzed countries. The results will be very useful if there is a pattern for different countries regarding the main effect of the financial crisis and the interaction with economic growth over the FDI. Taking into consideration the fact that we found that economic growth has a significant influence over the level of FDI and, moreover, a positive influence, the present study is very important in supporting the regulatory environment of those specific countries, in order to attract more FDI, as a solution for recovery of the economies affected by crisis.

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Keywords: Foreign direct investment; financial crisis; CEE countries; economic growth; regression model.

1. Introduction

Investments across countries are a powerful tool in promoting economic relationships between different parts of the world. Over the past two decades, the global foreign direct investments (FDI) flows had rapidly

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increased. Despite turmoil in the global economy, global FDI flows exceeded the pre-crisis average in 2011, reaching 1.5 trillion USD. However, they still remained some 23% below their 2007 peak (UNCTAD, 2012), when the value of FDI was 1,971 billion USD, about ten times more than the value recorded in 1990.

Our paper will analyze the relationship between the FDI flows and the financial crisis which started in 2008, emphasizing the case of CEE countries. Our study is the second attempt on a more extensive project that aims to study, to analyze and to argue the macroeconomic and microeconomic effects of the global crisis on FDI. Subsequently, this paper will be followed by more analyses, using existing data and recent research in the field. Overall, the project aims to offer a fully documented response to the question: is it necessary a special treatment (promotion policy) for FDI in time of crisis?

This paper is organized as follows: section 2 presents a short literature review on the relationship between FDI, economic growth and crisis. In section 3, we describe the methodology used, we show the data selection process and the characteristics of our sample and we report our results. Finally, we present our main conclusions.

2. Literature review on the relationship between FDI, growth and crisis

This is not the first financial crisis that caused a lot of debates. Researchers (Reinhart and Rogoff, 2008) identified and classified several financial crisis along the way, namely “The Big Five Crises”: Spain (1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1992) and other small banking and financial crisis such as: Australia (1989), Canada (1983), Denmark (1987), France (1994), Germany (1977), Greece (1991), Iceland (1985), Italy (1990), New Zealand (1987), United Kingdom (1973, 1991, 1995) and United States (1984).

A significant number of studies found similar results regarding the linkage between FDI and economic growth, through a comprehensive empirical analysis, using countries from around the world as samples. Alforo et al. (2000) pointed out the positive influence of FDI on economic growth, emphasizing the importance of local financial markets in this process. Furthermore, these results are confirmed by a series of studies which analyzed countries from different parts of the world. For Asia, Zhang (2001) found that the positive effect of FDI in promoting economic performance is stronger in the coastal part of China than the inland area. Moreover, Choong et al. (2004) emphasized that, for Eastern Asian countries, it is very important the development level of the financial sector. This can be seen as a source of competitive advantage in attracting FDI by host countries and, in the end, in promoting economic growth, results that are valid also for Taiwan (Chang, 2006), Malaysia and Thailand (Chowdhury and Mavrotas, 2006). This positive linkage between FDI and economic growth was also found for 18 Latin American countries (Bengoa and Sanchez-Robles 2003), and it could be improved by several elements from the host country, namely: adequate human capital, economic stability or liberalized markets. The same relationship was found to be true for other 10 African countries (Esso, 2010). But the results stated above were not confirmed by the empirical analysis conducted by Carkovic and Levine (2005), through which it was pointed that the FDI do not exert an independent influence on economic performance and their influence depends by other determinants of economic growth.

Even if there are a lot of papers that analyze different crisis in time, there is a scarce research regarding the relationship between the recent global financial crisis and FDI. The interest of researchers, who approached this topic, was to measure the strength of financial crisis over the FDI level. More specifically, the empirical study conducted by Ucal et al. (2010) revealed that the financial crisis had a powerful influence on FDI. After recording an upturn in the year(s) before the crisis, the level of FDI decreased in the followings years. Of course, FDI can be seen as a growth's vector for host countries and it can play a very complex and important role in micro economic responses to the financial crisis. This aspect is supported by the empirical analysis conducted by Alfaro and Chen (2010), through which, it is emphasized the importance of FDI in economic growth, volatility and economic interdependence across the countries in order to minimize the negative aspects

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