The contribution of foreign direct investment to clean energy use, carbon emissions and economic growth

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HIGHLIGHTS

- FDI inflows strongly lead to economic growth in the G20.
- FDI inflows lead to an increase in energy use in the G20.
- FDI inflows are in no relation to CO2 emissions in the G20.
- FDI inflows are in no relation to clean energy use in the G20.
- Economic growth is in negative relation to CO2 emissions in the G20.

ABSTRACT

The paper investigates the contributions of foreign direct investment (FDI) net inflows to clean energy use, carbon emissions, and economic growth. The paper employs cointegration tests to examine a long-run equilibrium relationship among the variables and fixed effects models to examine the magnitude of FDI contributions to the other variables. The paper analyzes panel data of 19 nations of the G20 from 1971 to 2009. The test results indicate that FDI has played an important role in economic growth for the G20 whereas it limits its impact on an increase in CO2 emissions in the economies. The research finds no compelling evidence of FDI link with clean energy use. Given the results, the paper discusses FDI’s potential role in achieving green growth goals.

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1. Introduction

Within policy circles, there is a widespread belief that foreign direct investment (FDI) enhances the productivity of host countries and promotes economic growth. The notion supports FDI may not only provide direct capital financing but may also create positive externalities via the adoption of foreign technology and know-how. Batten and Vo (2009) have shown that FDI stimulates economic growth through technology transfer, spillover effects, productivity gains, and the introduction of new processes and managerial skills. Fernandes and Paunov (2012) have recently shown that FDI has positive effects on innovation activities and manufacturing productivity. Hermes and Lensink (2003) reported that FDI plays an important role in modernizing the economy and promoting economic growth.

The historical data released by the World Bank indicate that FDI may have played an important role in addressing the growth challenges, in particular, in the group of twenty (G20) countries. The G20 is a group of heads of government or state from 20 leading economies, 19 countries plus the European Union, including Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States. Collectively, the G20 economies account for more than 80 percent of the gross world product, 80 percent of the world trade, and 62 percent of the world population, according to data from the World Growth Indicators. Most of the G20 economies are growing rapidly and as economic growth increases so too does the demand for energy. According to the International Energy Agency (2007), between 2005 and 2030 the world energy demand is expected to grow at an average annual rate of 1.8%. The G20 economies will contribute to 84% of the increase in the world energy demand.

Table 1 displays the summary statistics of 19 countries of the G20 during 1971–2010. There is a great deal of variation in mean per capita income with the highest mean per capita income levels 50,746 US dollars in Australia and the lowest 1375 US dollars in India with exhibiting an average of 23,078 US dollars in the G20, which is 252 percent higher than that of the world, an average of 9157 US dollars per capita in 2010. FDI net inflows per capita indicate a great deal...
of variation with the highest mean per capita FDI levels 24,678 US dollars in the United Kingdom and the lowest 163 US dollars in India, with exhibiting an average of 6284 US dollars in the G20. It is 220 percent higher than that of the world, an average of 2853 US dollars per capita during the period from 1971 to 2010. The mean energy use per capita ranges from 7481 kg of oil equivalent in Canada to 559 kg per capita in India with exhibiting an average of 24,678 US dollars in the G20 with 3470 kg per capita in the G20.

According to a report by the International Energy Agency (2011), the CO2 emission levels are relatively high in most of the G20 countries. Table 1 displays that the mean CO2 emission per capita ranges from 1.46 metric tons in India to 18.56 metric tons in Australia with exhibiting an average of 8.70 metric tons in the G20, which is 183 percent larger than that of the world, an average of 476 metric tons per capita in 2009. Along with the rapid economic growth in the G20 countries, the emission levels have been growing fast. Although a wide gap exists among the G20 countries, FDI and growth in the G20 countries, the emission levels have been growing faster than to the contemporary or preceding rates. Alfaro et al. (2010) have shown that FDI leads to higher additional growth in developed economies. Lee and Chang (2009) reported that FDI has a large direct effect on economic growth and extends the potential gains associated with FDI.

FDI is of special interest due to its supposed positive effects on growth. There is a widely accepted view that FDI promotes growth not only directly by augmenting capital formation in the recipient economy, but also indirectly by inducing human capital growth, helping technology transfers, and strengthening competition (Aitken et al., 1997; Kneller and Pisu, 2007). Thanks to these potential merits of FDI, both developing and developed countries have become more receptive to FDI inflows, and the global FDI flows have continued to increase except for short declines during 1982–1983, 1991–1992, 2001–2003, and 2008–2010. Aitken et al. (1997) have shown evidence of beneficial spillovers from multinational enterprises to the host economy, whereas Hsiao and Shen (2003) reported that economic growth is one of the important factors in attracting FDI, in particular in developing countries. Some studies indicate that the direction of causality between economic growth and FDI is subject to country-specific factors (Zhang, 2001). Kim and Seo (2003) reported that FDI has a positive but insignificant effect on GDP growth, while GDP growth has a significant and highly persistent effect on the future level of FDI in South Korea. Qi (2007) reported that the countries that are heavily dependent on petroleum exports have more difficulties than other countries in benefiting from FDI, and the role of total investment in impelling growth is also weakened in oil-exporting countries. The findings in the literature indicate that a country’s capacity to take advantage of FDI externalities might be limited by local conditions.

2.2. Economic growth, energy consumption and CO2 emissions

Hypothesis 2. Economic growth is in positive relation to CO2 emissions.

A fairly large amount of literature finds a causal relationship between energy consumption and economic growth, especially in
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