

Comparative Analysis Approach to Foreign Direct Investment and Economic Growth in Emerging Economies (1990-2017)

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Abstract: Several heterogeneity factors such as government policies on foreign trade, growth rate of economy, market size and cost of labour in emerging economies motivated this study. However, bulk of recent empirical cross country studies on FDI and economic growth in emerging countries have shown mixed results. Therefore, this study employs OLS technique to examine a comparative analysis of performance of FDI inflows in BRICS economies alongside with Singapore and Hong Kong in the last 27 years. Consequently, the findings from this analysis show that the principal determinant of FDI inflows in China is large market size, growth rate and GDP per capita growth. Meanwhile, only the market size is the principal determinant of FDI inflows in Brazil, India, South Africa, Singapore and Hong Kong and GDP per capita growth is an insignificant determinant of FDI inflows in both Russia and South Africa. This paper hereby recommends based on its findings that: the policy makers in Brazil, India, Russia Federation, South Africa, Singapore and Hong Kong should embark on policy measures that will facilitate a rapid expansion of the country's market size. This in turn will have a positive multiplier effects on the growth rate and GDP per capita growth in their economies. However, policy makers in China should embark on policy measure that will ensure the sustainability of the market size of the economy.

Keywords: FDI Inflows, Economic Growth and Emerging Countries

INTRODUCTION

Foreign direct investment has been identified as one of the critical economic variables that has integrated the world into a globalized economy [1]. It has been observed from the available data in the last four decades that global FDI inflow and outflow trends have moved paripasu. Global FDI inflows were first reported to get to their pinnacle in 2000, with an estimate of US\$1,363 billion. However, the greatest wave of FDI inflows and outflows were recorded in 2007, at US\$1,871.7 billion and US\$1,166 billion concurrently [2].

Consequently, from 1970 to early 2000 UNCTAD investment reports show that the advanced economies like the US, UK, Japan, France, Germany, Italy and Canada received about 60% of Global FDI inflows, followed by developing economies which accounted for 40% respectively. Similarly, FDI flows constituted about 40% of total cross-border investment in emerging economies between 1990s and 2000s [3].

However, from 2007 to 2017, there has been a paradigm shift in terms of size, flows and trend of global FDI. In the last few years FDI inflows have been consistently moving towards some emerging economies. Available data show that some countries that used to be at the lowest spectrum of FDI recipients in some decades ago are now competing with the developed economies in attracting FDI inflows. This scenario necessitated Goldman Sachs Investment Bank to constructively first coined Brazil, Russia, India and China as BRIC economic Block in which South Africa joined in 2010 to make the ACRONMS become BRICS. This newly carved economic block has been a prominent destination of FDI inflows in the last decade. However, in the last few years, Singapore and Hong Kong have come into limelight when it comes to FDI inflows destination. As a result of this new development research on FDI inflows in emerging economies cannot undermine these two countries. That is why the scope of this study goes beyond the popular BRICS countries. Having taken a critical look at the performance of these economies, it could be established that these countries have registered a quite steady growth rate in the last ten

years, apart from Brazil and South Africa in which political turmoil has negatively affected their economies in some four years ago. In fact, the average growth rates in these economies in the last one decade have surpassed those of G7 countries, which has called for global attention among the researchers and policy makers. This phenomenon above generated a catalogue of critical questions regarding to the factors that could have led to the sporadic growth in these countries. Meanwhile, Solow-Swan, 1956 acknowledged the contribution of investments to the economic growth of a country through accumulation of capital and employment generation potential. Coming from this background, FDI is expected to propel the frontiers of the productive capacity of a country. Johnson [4], submitted that FDI has the tendency to positively propel economic growth in the host country via direct formation of capital, jobs creation and exports, and also indirectly promote human capital and technology progress. The question whether FDI inflows have substantially contributed to economic growth in these emerging economies have sparked off debate in the literature over time. However, bulk of recent empirical cross countries studies on FDI and economic growth in emerging countries have shown mixed results, see Mehrara and Musai [5], Tan and Tang [6], Iamsiraroj [7], Ryan [8], Seyoum *et al.*, [9]. Moreover, bulk of the principal determinants of FDI inflows in these countries under study have several heterogeneity factors such as government policies on foreign trade, Infrastructure, market size, cost of labour, natural resources, low political risk and business climate which might not make cross countries analysis a true reflection of impact of this economic variable on the growth. In order to fill the above gap and update the existing literature, this study will focus on comparative analysis of seven emerging economies namely, China, Hong Kong, Singapore, Brazil and India, Russia Federation and South Africa, Singapore and Hong Kong. These countries were top emerging countries that have attracted FDI from 1990 to 2017. It is assumed that 27 years is long enough to examine how FDI inflows have diffused into the different productive sectors that make up the economies of these countries.

LITERATURE REVIEW

Theoretical literature Review

This study considers the following theories relevant as the theoretical foundation to substantiate how FDI and economic growth are linked.

The Neoclassical Theory of Capital Movement versus Endogenous Growth Model

Under this theory, it is assumed that under perfect competition and no transaction cost, the justification for international capital movements relied heavily on changes in interest rate differentials of a host economy and the rest of the world. This theory regarded the movement of foreign investment across countries as a strategic part of the international factor movements. However, Hecksher-Ohlin [10] model submitted that international migration of factors of production, alongside with cross border investment, are determined by various proportions of the inputs of primary production present in various countries. International capital movement connotes migration of funds for investment projects from economies where capital is relatively abundant to economies where capital is relatively scarce. These international investments may be of mutual benefits to both the investing and host nations in terms of increased income, profits and higher productivity.

However, it has been established in the literature that one of the principal features associated with endogenous growth model is the absence of diminishing return to capital. Therefore, it is assumed that the production function without diminishing returns can be expressed as

$$Y = AK \text{ ----- (1)}$$

From the above model ``A`` represents a positive constant (such as registered in the Cob Douglas production function), that is, an index of the technological level. Here ``K`` may be viewed in a broad sense to denote physical and human capital so as to assume away the absence of diminishing returns to capital in the AK production function. It could be inferred that output per capita is $y = Y/L = A \cdot K/L = AK$ and the APL and MPK are constant at the level $A > 0$.

Interestingly, liberalization of the national economy invariably attracts both additional domestic and foreign investment and thus catalyzes the rate at which capital is accumulated which in turn drives the growth of the economy in the long run.

Empirical Literature Review

Table-1: This section provides the review of past studies on link between FDI and economic growth in the developed, emerging and developing economies

Author and Year	Country	Methodology	Results
Loree and Guisinger [11]	United States of America	Panel Analysis	The policy of host country relating to the variables of interest and FDI are significant in developed economies. Meanwhile, infrastructure was identified as a major determinant of FDI for all the regions
Sing and Jun [12]	Developing Nations	Qualitative Analysis	The authors submit that there exists a direct relationship between taxes on international transactions and inflows of FDI to developing economies, as the export related variables strongly substantiate inflows of FDI to an economy
Duran [13]	Latin America	Panel Data and Time Series Techniques	The author concludes that the catalysts of FDI are trade openness, the size, growth, domestic savings, country's solvency, and macroeconomic stability variables
Beven and Estrin [14]	Transition Economies in Central and Eastern Europe	Panel Analysis	The findings from the study argue that country risks are influenced by reserves, corruption, private sector development, the government balance and industrial development. However, a dummy variable adopted to capture the principal announcements of progress in European Union accession shows a positive influence on inflows of FDI.
Garibaldi <i>et al.</i> , [15]	26 Transition Economies in Eastern Europe and the Former Soviet Union	The Regression Estimation	The authors posit that market size, trade openness, fiscal deficit, inflation and exchange rate regime, risk analysis, natural resource endowments, economic reforms, barriers to investments and bureaucracy are principal determinants of FDI flows.
Levy-yeyati <i>et al.</i> , [16]	USA and European Countries	Adopting a Gravity Model	It was discovered from the study that FDI flows from US and European countries move in a counter cyclical way to the business cycle in the source country. Also, the cycles of interest rate are the key determinants of inflows of FDI.
Aguilar and Vallejo [17]	Latin America	They use Gravity Model	The paper summarizes that the size and development of both the domestic and foreign economies, the distance between them and the existence of common language are the major determinants of bilateral FDI flows.
Sahoo [18]	South Asian Countries.	Panel Co-integration Test	The paper identified infrastructure index, the market size, labour force growth, and trade openness as the major determinants of the FDI inflows in South Asian economies.
Tang [19]	China	Cointegration Analysis	It was discovered from the study that FDI has a direct relationship with output. However, it has a limited impact on domestic investment
Shan [20]	China	VAR Modelling	The author finds that output is not significantly caused by FDI, meanwhile it has a principal influence in its determination
Bende-Nabende <i>et al.</i> , [21]	APEC Countries	Vector Autoregression (VAR) Methodology	The authors argue that economic growth is a function of factors such as capital formation, human capital, employment, FDI, openness of the economy and technology transfer
Aderemi and Aberu [22]	Nigeria	Causality Approach	The paper concludes that there exists a unidirectional causality which runs from FDI to economic growth as well as non-oil exports in Nigeria
UNACA [23]	31 African Economies	Panel Data Analysis	The study concludes that the major determinants of FDI inflows in Africa are past FDI inflows, market size,

			corruption, domestic credit, share of oil in exports and religious tension risk.
Brambila-Macia and Massa [24]	Some Selected Countries in SSA	Panel Analysis	The finding from the paper concludes that both FDI and cross-border bank lending have a significant direct relationship with economic growth in the continent of Africa.
Ogun, Egwaikkhide and Ogunleye [25]	Sub-Saharan Africa (SSA)	Granger Causality and Simultaneous Estimation Techniques	The study shows that; there exists a statistically significant between FDI inflows to real exchange rate movements in Africa.

Source: Authors` Compilation, 2018

Consequently, from the reviewed empirical studies above, it could be deduced that researches are still on going about FDI inflows in developed, developing and emerging countries in the world, but their findings have shown mixed conclusions and policy recommendations. This proves that literatures are still

inconclusive about the way FDI affects economic growth in emerging economies. Hence, the relevance of this study.

OVERVIEW OF THE SELECTED EMERGING ECONOMIES

Table-2: Annual GDP growth rate in emerging economies in the last decade

Year/Country	China	India	Hong Kong	Singapore	Brazil	South Africa	Russia
2007	14.2	9.8	6.5	9.1	6.1	5.4	8.2
2008	9.7	3.7	2.1	4.7	5.1	3.2	5.2
2009	9.4	8.5	-2.5	1.8	-0.1	-1.5	-7.8
2010	10.6	10.3	6.8	-0.6	7.5	3.0	4.5
2011	9.5	6.6	4.8	15.2	4.0	3.3	5.3
2012	7.9	5.5	1.7	6.4	1.9	2.2	3.7
2013	7.8	6.4	3.1	4.1	3.0	2.5	1.8
2014	7.3	7.4	2.8	5.1	0.5	1.8	0.7
2015	6.9	8.2	2.4	3.9	-3.5	1.3	-2.8
2016	6.7	7.1	2.2	2.2	-3.5	0.6	-0.2
2017	6.3	6.6	3.8	3.6	1.0	1.3	1.5
Average	8.8	7.3	2.9	5.0	2.0	2.1	1.8

Source: World Development Indicator, 2018

From the above table, the average growth rate in China in the last ten years shows that the economy has been expanding rapidly. It is the fastest growing economy among the leading emerging economies of the world. Meanwhile, India and Singapore concurrently occupy the second and third fastest growing economies among the emerging economies. Brazil and South

Africa and Russia Federation registered impressive growth rate in 2007, 2008, 2010 and 2011. However, Hong Kong showed noticeable growth rate in 2007, 2010 and 2011. It is important to state here that the Russia federation is the least growing economy among the emerging economies under consideration.

Table-3: FDI giants in 2016; top 12 countries by FDI inflows, USD millions, current prices

1	USA	391104
2	UK	253825
3	China	133700
4	Hong Kong	108125
5	Netherlands	91956
6	Singapore	61593
7	British Virgin Island	59679
8	Brazil	58190
9	Australia	44967
10	Cayman Island	44485
11	India	37667
12	Russian Federation	33721

Source: Author's calculation from UNCTADstat, 2017.

From the table-3, it could be deduced that five newly emerging economies namely China, Hong Kong, Singapore, Brazil and India were among the 12 highest recipients of global FDI inflows in 2016.

It is worth of note to recognize the multiplier effects of FDI on the host economy, especially economic growth. These countries have registered substantial growth in their economies in the last ten years.

Table-4: GDP per Capita Growth in emerging economies in the last decade

Year/Country	China	India	Hong Kong	Singapore	Brazil	South Africa	Russia
2007	13.6	8.2	5.6	4.7	4.9	4.3	8.7
2008	9.1	2.4	1.5	-3.5	4.0	2.1	5.3
2009	8.9	7.0	-2.7	-3.6	-1.1	-2.6	-7.8
2010	10.1	8.8	6.0	13.2	6.5	1.8	4.5
2011	9.0	5.2	4.1	4.2	3.0	1.9	5.2
2012	7.3	4.1	0.6	1.6	1.0	0.8	3.5
2013	7.2	5.1	2.7	3.4	2.1	1.0	1.6
2014	6.8	6.1	2.0	2.5	-0.4	0.4	-1.0
2015	6.4	6.9	1.5	1.0	-4.4	-0.1	-3.0
2016	6.1	5.9	1.5	1.1	-4.3	-0.7	-0.4
2017	6.3	5.4	1.3	3.5	0.2	0.1	1.4
Average	8.3	5.9	2.2	2.6	1.0	0.8	1.6

Source: WBI, 2018.

From the table above, it could be established that China has the highest average GDP per capita growth, followed by India and Singapore concurrently. Meanwhile, South Africa is the least among these countries.

METHODOLOGY

This study utilizes secondary data from 1990 to 2017. Data on FDI inflows were extracted from UNCTAD database published by the World Bank. Meanwhile, data on other variables employed for the study were extracted from World Bank Indicator. However, Ordinary Least Square technique was adopted to address the objective of the study with the aid of E-Views software.

Model Specification

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

$$FDI = F(GDP, GRT, GDP/CA) \dots\dots\dots (I)$$

Linearization of model I leads to model II

$$\ln FDI_t = \beta_0 + \beta_1 \ln GDP_t + \beta_2 GRT_t + \beta_3 GDP/CA_t + E_t \dots\dots\dots (II)$$

Where FDI represents net FDI inflows into the host economies, GDP is used to proxy the market size of the country meanwhile, GRT denotes the rate of growth of the economy, GDP/CA denotes investment per capita, E connotes error time and t ranges from 1990 to 2017.

With the estimation of (II), the values of the coefficients of β_1 , β_2 , and β_3 will be used to determine the significant or otherwise of determinants of FDI inflows in the countries under consideration.

RESULTS AND DISCUSSION

From table-4, it could be deduced that the market size denoted by GDP of economies like Brazil, India, China, South Africa, Singapore and Hong Kong have a significant positive relationship with FDI inflows. This finding corroborates the assertion of Sahoo [18] who posits that the market size is the principal determinant of the FDI flows in South Asian economies despite the fact that different methodology was adopted in this paper.

India’s market size shows the highest contribution to FDI inflows, as a unit change in market size leads to 98% of FDI inflows in the economy. This is followed by South Africa, which a unit change in its market size leads to 23% increment in FDI inflows into the countries. Singapore came third, China fourth and Hong Kong fifth concurrently. However, it is only the Market size of the Russian economy that shows a negative relationship with FDI inflows. This implies that countries with lower market size receive less FDI inflows and verse versa. Consequently, the growth rate of the economy shows a positive relationship in all the emerging economies under consideration. This result is in with the work of Nonnenberg and Mendonca [26]. It is worth of note to state here that it is only China’s growth rate that is statistically significant at 5% level of significance. This implies the growth rate of the economy is the principal determinant of FDI inflows only in Chinese economy. In the same vein, the GDP per capita growth shows inverse relationship with FDI

inflows in Brazil, India, Singapore and Hong Kong. The finding from this study is validated by the works of Dauti [27], Walsh and Yu [28], Rivera and Castro [29]

and Grubaugh [30] who find similar results in comprehensive studies from emerging and developed economies.

Table-4:

Countries	Market Size	Growth Rate	GDP/Capita Growth	R Squared	Adjusted R Squared	Durbin-Watson stat
Brazil	14*** (3.7)	6.7** (1.7)	-6.8** (1.7)	0.82	0.79	1.2
Russia	-29*** (0.6)	5.5** (0.1)	1.1** (1.4)	0.63	0.59	0.6
India	78*** (2.4)	2.2** (1.7)	-2.2** (1.8)	0.84	0.81	0.8
China	15*** (13.6)	2.7** (3.9)	2.7** (4.2)	0.97	0.96	1.3
South Africa	23*** (2.0)	9.8** (0.6)	1.1** (0.8)	0.73	0.68	1.7
Singapore	16*** (6.5)	1.8** (0.4)	-1.9** (1.1)	0.67	0.62	2.5
Hong Kong	7.6*** (9.3)	4.6** (0.1)	-4.7** (0.1)	0.79	0.76	1.2

Source: Authors' Computation, 2018 Note Figures in the parenthesis represent t- value. A constant term is included but not reported

Meanwhile, GDP per capita growth shows direct relationship with FDI inflows in Russia, China and South Africa. Among these three countries, it is only China that GDP per capita growth is significant.

CONCLUSION AND RECOMMENDATIONS

A critical comparative evaluation of link between FDI inflows, economic growth, growth rate, and GDP per capita growth in seven emerging economies has been carried out from 1990 to 2017 in this paper. It is evident that the following summary can be iron out owing to the results that emanated from the analysis of this study:

The large market size of the six emerging economies namely China, India, Brazil, Hong Kong, South Africa and Hong Kong is the principal determinant of FDI inflows in these countries. China, India and Brazil are the first three largest emerging economies in the world respectively. As a result of this factor, these economies have been the destination of FDI inflows in the recent time. Moreover, this study shows a direct relationship between FDI inflows and growth rate of all the emerging economies. However, it is only Chinese economy that is significant among the economies under consideration. This implies that the exceptional and aggressive growth rate of Chinese economy in the past decade has been a major contributory factor that facilitates sporadic inflows of the FDI into this country. Also, GDP per capita growth show positive relationship with FDI inflows in three countries namely China, Russia and South Africa. Meanwhile, reverse is the case for other four countries. From this study, it could be concluded that market size, growth rate and GDP per capita are the principal

determinants of FDI inflows in China. On the other hand, it is only the market size that is the principal determinant of FDI inflows in Brazil, India, South Africa, Singapore and Hong Kong. However, growth rate and GDP per capita growth are insignificant determinants of FDI inflows in both Russia and South Africa. But growth rate is an only insignificant determinant of FDI inflows in four countries; Brazil, India, Singapore and Hong Kong.

Consequently, this paper hereby recommends based on its findings that: the policy makers in Brazil, India, Russia Federation, South Africa, Singapore and Hong Kong should embark on policy measures that will facilitate a rapid expansion of the country's market size. This in turn will have a positive multiplier effects on the growth rate and GDP per capita growth in the economy. However, policy makers in China should embark on policy measure that will ensure the sustainability of the market size of the economy for the future. If these variables continue to grow on a sustainable basis in China, the economy will be the major destination of FDI inflows not only among the emerging economies but also in the world.

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