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Knowledge spillovers, absorptive capacities and the impact of FDI on economic growth: empirical evidence from transition economies

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Abstract

In this paper we employ econometric analysis to investigate the impact of FDI and the related externalities on economic growth in transition economies. We contribute to recent literature by using more reliable measure of FDI while also depicting the character of FDI and related knowledge spillovers, as well as by examining the importance of technological and innovative capabilities in explaining the growth performance among transition economies, not previously studied. Overall, the results of our empirical analysis seem to render support to the hypothesis that FDI contribute to economic growth predominantly through knowledge spillovers, and that the higher level of technological development proxied by government and business R&D expenditures is associated with better growth performance among transition economies. Essentially, by the way we measure FDI in this analysis (i.e. the share of FDI in the manufacturing gross value added) and in the view of the integrated framework in which we study the relationship between FDI and economic growth, allows us to stipulate that the positive impact of FDI on economic growth is associated with more knowledge-capability and efficiency-seeking FDI.

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1. Introduction

In the theoretical literature FDI is assumed to directly affect economic growth by contributing to gross fixed

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capital formation and indirectly by contributing to knowledge stock. More precisely, in the traditional framework FDI is expected to directly affect economic growth since FDI is assumed to complement domestic investments, and considered to be important supplement for capital and investment shortages. However, along the lines of more recent endogenous growth models (Romer (1986:1990), Grossmann and Helpman (1991), FDI may also be assumed to indirectly contribute to economic growth by increasing the stock of knowledge and by fostering technological growth of a technologically inferior recipient economy, hence stimulating domestic investments.

The overall purpose of this study is to investigate the exogenous impact of FDI on economic growth, as well as to study the influence of technological and innovative capabilities on growth performance among transition economies, not previously investigated. We embark from previous literature by using more quality data on FDI. FDI in this study is defined as the share of FDI in the manufacturing gross value added, to reflect on foreign investments in the more productive, supposedly technologically more sophisticated sectors of the economy, and the related knowledge spillovers. By the way we measure FDI in this analysis we attempt to at least partly account for the nature of FDI (e.g. motives of investments and function FDI is to serve in the host economy). Further we advance existing growth literature by accounting for the differences in technological and innovative capabilities among transition countries. In order to depict on a wider scope of technological proficiency and development of host economy innovative/imitative capabilities of firms and industries, assumed important along the lines of endogenous economic growth models, we incorporate two R&D variables, i.e. government and business R&D expenditures. In the literature innovative/imitative capabilities proxied by R&D expenditures are considered important factor influencing economic growth, possibly determining the extent to which FDI can be considered an important source of technological advance in host economy.

We use panel data estimations to credit the time-evolving, interrelated and interdependent nature of wide range of technology-related factors, in examining the relationship between FDI and growth. Finally, in face of data limitations, we analyze growth dynamics in the period 2000-2013, and while referring to the (isolated) case of more advanced transition economies of Central and Eastern Europe (CEE-10). We are interested in analyzing growth performance, among which are somewhat similar in terms of their economic structures relative to other transition economies (e.g. Southeast European countries); related legacies of socialism and command economy, as well as, and above all, among countries similar in terms of their more recent experience with institutional and transition reforms. Understanding factors underpinning growth among this particular group of countries seems important from the theoretical stand point and for policy discussion (see Campos and Kinoshita 2002, Menzinger, 2003). Furthermore, by studying growth performance on the isolated sample of transition economies we tend to minimise the potential biases associated with previous studies on economic growth which tend to judge growth performance from pooled data as discussed by Bloningen and Wang (2004).

Essentially, the results of this empirical investigation reveal that FDI exerts a significant and positive impact on economic growth, along the complementary positive impact of domestic investments on economic growth. Further we find that technology related variables depicting technological and innovative capability of a host economy seem to have pervasive positive influence on economic growth in these countries. Both government and business innovative efforts (i.e. proxied by R&D expenditures) seem to be the fundamental driving force behind economic growth also among transition economies. Last but not least, the suggested positive impact of FDI on economic growth in this study is associated with more productive e.g. knowledge capability seeking character of FDI inflows and the related knowledge spillovers in these countries.

The paper is organized as follows. Section 2 provides a theoretical basis of investigation and briefly discusses the empirical literature. Section 3 presents the model and the methodology used in the empirical analysis of panel data on 10 CEECs between 2000-2013. Section 4 discusses the results and policy implications, while section 5 concludes.

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