Country Conditions and their Impact on FDI Flows: Evidence from SIDS

Densil A. Williams
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Setting the Context

- Since 2008 SIDS have been saddled with high debt burden and low levels of economic growth due mainly to external shocks in the economic and environmental arena **(UN Conference on SIDS- SAMOA, September 2014)**

- "…Today – nearly six years after the onset of the world financial crisis – SIDS are still dealing with its fallout. The decline in tourism in the aftermath of the global financial crisis contributed to the increase in public indebtedness of SIDS. The high import prices of food, fuel and other commodities have worsened their public debt ratios. As a result, a number of SIDS have debt burdens in excess of their GDPs, with more than 20% of government revenues allocated for debt servicing. Among other effects, high debt burdens constrain SIDS governments' fiscal space, reduce their essential public expenditures and erode their abilities to invest in physical and social capital."

Setting the Context

- Economic Growth has become the number one priority for policymakers in the SIDS
  - Recognizing that economic growth has stalled in SIDS, Member States, in the ongoing consultations on the outcome document of the SIDS Conference, have emphasized the importance of achieving higher economic growth…. ***(Wu Hongbo UN DESA's Under-Secretary-General & Secretary-General for the Third International Conference on SIDS)***

Setting the Context

- Size of SIDS makes it difficult for growth to be driven by internal resources only (Wint, 2003)
- External resources through FDI is critical to drive growth
- FDI and Economic Growth are directly related (Wint & Williams, 2002; Barclay, 2004; Umeroa, 2013)
- Locational Challenge to Increase FDIs in SIDS- majority of FDIs go towards high income SIDS (UN Conference – SAMOA, 2014)

Setting the Context

- Locational Issues are more critical in SIDS given the market failure associated with FDI projects

- Similarly, high levels of macro-economic instability in SIDS has stimulated the need for further work on the country conditions that impact FDIs flows

Setting the Context

Theoretical Insight

- Eclectic Paradigm – OLI Theory
  - FDIs flow because of **O**wnership advantage which must be **I**nternalized in a suitable **L**ocation
- Location **most** critical in the case of SIDS given size, vulnerability, remoteness and economic conditions

Research Question

- What macro-economic variables **(country conditions)** are most important to the attraction of FDIs in SIDS?

Method

- To motivate the study, a general model of FDI flow to SIDS was developed

$$\text{FDI Flows} = \int(X_1, X_2 X_3 \ldots . X_n) \quad \mathbf{1}$$

Where:

- $X_1, X_2, X_3 \ldots X_n$ represent vectors of variables drawn from various elements of the OLI paradigm

Method

- Major focus was on the Location variable as captured through conditions for macro-economic stability

- 12 year Panel of 35 SIDS was used as main data source.

  - Data gathered from UNCTAD, World Investment Report, IMF- International Financial Statistics and World Bank

Method

- $\log Y_{it} = \gamma + \beta_1 \log(g_{it}1) + \beta_2 g_{it}2 + \beta_3 g_{it}3 + \beta_4 g_{it}4 + \varepsilon_{it}$ **2**

Where:

- $\log Y_{it}$ = FDI flows to country I over time t
- $g_{it}1$ = per-capita income for the Ith country over time t
- $g_{it}2$= fiscal deficit in percentage of GDP of the Ith country over time t
- $g_{it}3$= current account balance as a percentage of gdp of the Ith country over time t
- $g_{it}4$= debt to gdp ratio if the Ith country over time t
- ε_{it} = Error-term

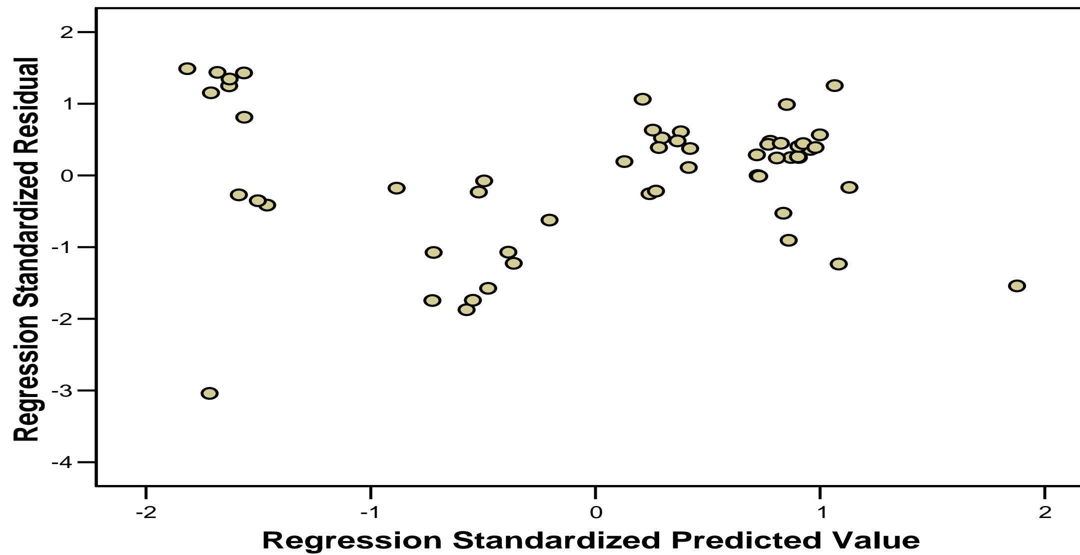
Preliminary Findings

: Multivariate regression-determinants of outward FDI

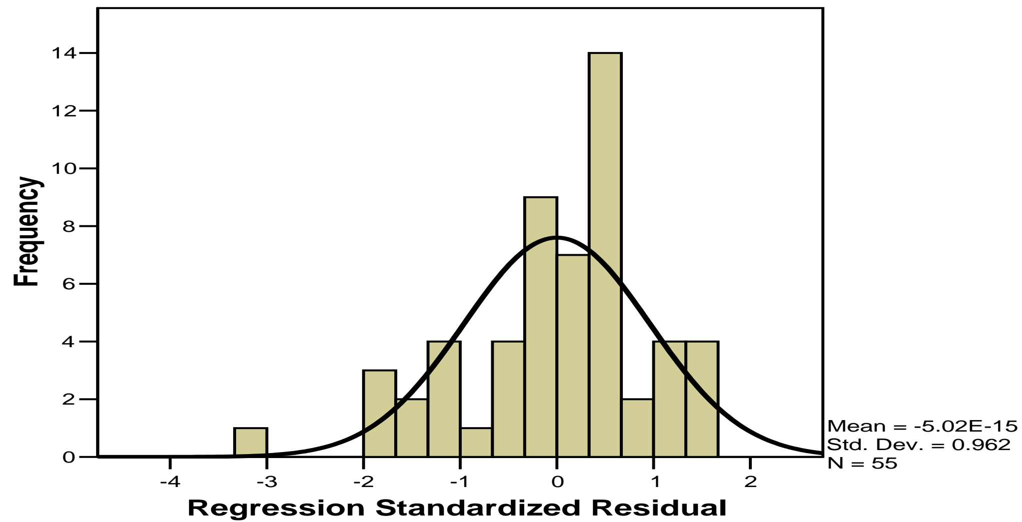
Variables	Beta	T	p-value
logpercapitaincome	0.792**	2.748	0.008
Current Account Balance	0.000	0.120	0.905
Fiscal Balance	0.029	0.726	0.471
Debt to GDP	-0.004	0.767	0.447
Constant	16.495**	15.138	0.000
R2	.162		
Adjusted R2	.094		
F-statistic	2.409 (0.062)		

Dependent variable = LogFDI **: Variables significant at the 5% level of significance ($p < 0.05$)

Preliminary Findings



Preliminary Findings



Discussion and Concluding Thoughts

- The results from the analysis revealed that: the **level of per-capita income not the fiscal deficit, current account balance nor the debt burden (debt to gdp ratio**) is most critical in attracting FDIs to a host location.
- Findings similar to Wint & Williams, 2002; Li; 2013)
- FDIs are going where persons have money to spend
- Interestingly, while FDI helps to drive growth, a growing economy is also critical to attract FDIs.