Effect of Foreign Direct Investment on Economic Performance
An International Empirical Evidence

A RESEARCH TOPIC
PRESENTED TO BUSINESS SCHOOL
LEBANESE AMERICAN UNIVERSITY

IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE
MASTER OF SCIENCE IN BUSINESS
MANAGEMENT

BY
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FEBRUARY, 1995

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DEGREE : MASTER OF SCIENCE IN BUSINESS MANAGEMENT
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TITLE OF RESEARCH TOPIC : EFFECT OF FDI ON ECONOMIC PERFORMANCE : AN INTERNATIONAL EMPIRICAL EVIDENCE

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DEDICATION

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THIS RESEARCH IS LOVINGLY DEDICATED
TO MY

FATHER

MOTHER

BROTHERS

AND SISTERS

ABSTRACT

The purpose of this study is to find the effect of FDI on the economic performance of developing and developed countries by compiling data about 96 countries.

Chapter I has presented a genaral background for the reasons that led to the rise of FDI and talked briefly about the role of Foreign Direct Investment in Development.

Chapter II is divided into two parts. The first one parades an overview about the theory of FDI, its definition, explanations and previous literature. Part two presents experiences of FDI in some countries of the world.

Chapter III dicusses the procedures and methodology adopted in analyzing the data collected. The selected sample comprises of 96 developed and developing countries. The data was analyzed by using the SPSS statistical package aswell as percentage analysis and graphical representation of data.

Chapter IV presents the findings of this research starting with the characteristics of the selected sample. Then the results of the regression analysis are scrutinized. Hence chapter IV answers the questions posed in chapter I.

Chapter V launches some recommendations in compliance with the findings of this research. These recommendations call for adopting FDI as well as further research concerning this topic.

ACKNOWLEDGEMENTS

It was Dr. Charbagi's idea to work on FDI because this new topic has not been tackled before.

I am grateful to all those who have contributed (not always knowingly or willingly) to my education and my preparation pertaining to this vitally important area. Obviously they can not all be named here, but I would remiss if I did not identify and thank Mr. Hasan Dakroub and Mr. Adel Daadaa.

Yet I have to confess that I owe a large debt of gratitude to my first advisor Dr. Abdul Razak Charbagi for his thorough and insightful reading of numerous drafts and guidance without which this research would have not been undertaken.

Above all, I would like to express my sincere appreciation and deep gratitude for Dr. Tarek Mikdashi for his support, constant encouragement and guidance.

Special and sincere appreciation to my loyal and beloved friends in the Business Computer Center.

Finally I wish to express my deepest gratitude to every member of my family for their support, valuable help, encouragement and understanding.

LIST OF TABLES

LIST OF FIGURES

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

General Background

Midway through 1984 an optimist coined the term, "the great debt crisis of 1982-84". Almost seven years after the summer of '82, when "the global debt crisis" burst on the world stage as a matter of acute widespread concern, the situation continues to fester. The World Bank's report that keeps an annual tab on the subject, has rendered an indisputable judgement: "an end to the debt crisis remains elusive." With the passage of time the situation remains a crisis waiting for a breakdown, defining "crisis" in the dictionary sense of that much absurd term: "....in political, international or economic affairs, an unstable condition in which an abrupt or decisive change is impending."

The external debt burden of the developing countries has continued to increase since the summer of 1982. It was then that the Mexican government declared that it could no longer continue to service its foreign debt on a

business-as-usual basis, thereby dramatically precipitating a world-wide awareness of a "debt crisis" with global ramifications. In 1989, Third World has mounted to a total in excess of $1300 billion. The servicing of this debt absorbs a very high percentage of the debtors' export earnings. In some cases the debt servicing would absorb almost all if some form of debt relief were not forthcoming by agreement between the creditors and debtors, or by unilateral action taken by the debtors. Little wonder that, as of September 1988, there were 24 countries declaring their inability to service their debts and standing in the rescheduling line-up and that, as of April 1989, about a dozen countries are more than six months overdue in their repayments to IMF and the World Bank.

There were frequent debt reschedulings before 1982. The underlying reason for the dramatic impact and the widespread concern with the rescheduling of Mexico's debt in mid-1982 lay only partly in the fact that Brazil soon followed suit. By virtue of the amounts involved and the publicity defiant manner of their declarations in halting payments, their actions became newsworthy. However, the more serious factor giving rise

to such intense concern was the sudden awareness that the situation in its dynamic was perceived to be unsustainable-if other debtors were to follow the Mexican and Brazilian precedents...[1]

In the meantime, the debtors face an uncongenial global environment, characterized by the following features:

* The protective barriers that the developed creditor nations put in place in a former era have not been lowered far enough to enable debtor countries to earn foreign exchange with which to service their debts.
* The prices of commodity exports and the terms of trade have not improved to any significant degree and, in many cases, have worsened.
* Once overly friendly commercial bankers and investors have decidedly cool, lending only under the pressure of rescheduling agreements, and investing only under exceptionally favorable terms.
* Official development assistance (ODA) has fallen in real terms, even as

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[1] Morris Miller, Resolving the Global Debt Crisis : UNDP Policy Discussion Paper, UNDP NY, 1989, pp. 11-16.

the need for a substantial increase in both the volume of aid and its degree of concessionality has become more and more acute.[2]

During the last few years restructuring process has been embellished by new variants of "financial packages" involving the mixing-and-matching of "new" financial instruments tailored to suit each case-the so-called "menu approach". The instruments and procedures offer both debtors and creditors a veritable smorgasbord of choices from currency-switching options to repurchase of discounted debt, and a variety of conversion techniques, such as debt-equity swaps and "exchange offers with debt defeasance through collateralization. The list of recent developments in what is called "the debt workout process" includes the following:

- discounted debt repurchases;
- new money instruments, such as new money bonds and commodity-linked bonds;
- interest retiring agreements;
- interest capitalization;

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[2] Ibid , p. 28.

- facilities for trade financing, contingency financing and bridge financing;
- interest and currency switching options;
- securitization, and;
- currency switching techniques, e.g. debt-equity conversion mechanisms , exit instruments and exchange offers with debt defeasance through collateralization.

These proposals have a modest objective, that is, preventing a breakdown by reducing the stress of servicing debt without making significant changes in the prevailing global financial system.[3]

Efforts by banks and by official creditors to secure equitable burden sharing in the provision of debt relief or concerted financing are evidenced by the parallel pace of bank and official restructurings.[4]

In spite of all these trials, it is noticed that debt remains a problem with

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[3] Ibid, p. 65.

[4] Peter M. Keller with Nissanke E. Weerasonghe, Multilateral Official Debt Rescheduling: Recent Experience, (Washington DC : International Monetary Fund: 1988), p.18.

respect to both debtor and creditor countries.

The 1990's started to face a trend that has been growing since the 1970s. This trend is known as Foreign Direct Investment (FDI).

What is FDI ?

Edward M. Graham and Paul R. Krugman define FDI as " ownership of assets by foreign residents for purposes of controlling the use of those assets. In most cases, however, the foreign "resident " is a firm - a legal person but not an actual one. "[5]

The Role of Foreign Direct Investment in Development

Foreign direct investment can have a longer-term beneficial impact on a country's development since it is generally directly linked to productive investment and also facilitates the transfer of technology and managerial and marketing skills, the diffusion of which can have substantial effects on productivity growth. In addition to the direct impact of such transfers, the

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[5] Edward M. Graham and Paul R. Krugman, Foreign Direct Investment in the United States, (Washington DC : Institute For International Economics: 1991),p.7.

introduction of efficient and internationally competitive enterprises into an economy can also help foster a more general, longer-term improvement in productivity by stimulating the adoption of improved technology and management in other sectors of the economy, in particular among local competitors and suppliers. There are, however, a wide variety of institutional arrangements through which such transfers can be channeled, and alternatives to transfers through wholly- or majority-owned foreign affiliates may sometimes be better suited to the sensibilities of host countries.

In addition, foreign direct investment has become more important in the light of the sharp decline in new commercial bank lending since the onset of widespread debt-servicing difficulties among borrowers. New net banking is likely to continue to be constrained, particularly for those countries with especially large amortization payments of rescheduled debt falling due over the next several years. A greater emphasis on policies designed to attract direct investment could offset part of the overall decline

in bank lending.[6]

Need For the Study

Based on the review of literature, there is a growth in FDI and its importance increased but in the past there was a lack of using sophisticated statistical techniques in analyzing the effect of FDI on Economic performance " Yet so far there has been a remarkable absence of serious analytical discussion of the subject. Both the critics and the defenders of FDI have relied primarily on anecdotes and *a priori* judgements rather than on systematic analysis of the data. " [7]

With the availability of data on FDI and the availability of advanced computer software, it becomes imperative to test the effect of FDI on economic performance in order to bridge the gap between theory and the empirical evidence.

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[6] Foreign Private Investment in Developing Countries, Occasional Paper No. 33, (Washington D.C., IMF Jan.: 1985), p.2.

[7] Edward M Graham and Paul R. Krugman, p.1.

Statement of the Problem

What is the effect of FDI on economic performance for developed and developing countries ?

Research Questions

1- What are the major characteristics of countries of the selected sample for the study ?

2- What is the relative importance of FDI on the economic performance holding the effect of government regulations, government administrations , government incentives constant ?

Operational Definition of Terms

Debt-Equity Swap - refers to a debt-reduction technique in which there is the exchange by a debtor country of portions of its external debt for ownership in state-owned enterprises. This is what occurs : (1) the buyer of the debt (at a discount on the secondary market) makes a loan

to the debtor country; (2) the buyer then obtains (in exchange) local currency at its full face value, and (3) the buyer then uses this local currency to purchase local equity in the country. Example: to give themselves breathing room, many Third World debtor countries have tried to interest their developed-country bank creditors in debt-equity swaps involving state enterprises such as telephone companies and hydroelectric projects.

Debt rescheduling - the formal deferment of debt service payments with new maturities applying to the deferred amounts.

FDI - Foreign Direct Investment

Government regulations - possible foreign ownership, both with and without government approval, permissible repatriation of profits and the proceeds of sale or liquidation, and whether or not the country is a signatory to four key multilateral conventions. These conventions are the convention on the settlement of investment disputes between states and nationals of other states, the convention establishing the Multilateral Investment Guarantee Agency, New York convention on

the recognition and enforcement of foreign arbitral awards, and the Paris convention for the protection of industrial property, like exchange control.

Government administrations - assesses the performance of the agency responsible for promoting, regulating or assisting direct investment projects.

Government incentives - the incentives available to the foreign investor like subsidies and tax rates.

IMF - International Monetary Fund

CHAPTER II

FOREIGN DIRECT INVESTMENT

Part One

An Overview

With the exception of natural resource development, foreign direct investment was not significant until after the second World War. The phenomenal growth in the ownership of foreign-located income-producing assets began in the mid-1950s, extending through the decade of the 1960s. The major currency realignments of the later 1960s and 1970s were the first to occur with substantial direct investments in place. This prompted investigations on the operations and profitability of existing foreign investments.[1]

The Theory of FDI

Why might a foreign firm be willing to pay more for an enterprise than the domestic firm ?

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[1] Michael H. Siegel, Foreign Exchange Risk and Direct Foreign Investment, (UMI Research Press, Ann Arbor, Michigan: 1983), p.7.

There are two possible reasons :

First, the foreign firm expects the annual cash flow to be larger - that is, the enterprise is more profitable in foreign hands.

Second, the foreign firm values any given cashflow more highly, because it has a lower cost of capital than the domestic firm.[2]

Explanations of FDI :

A- Cost-of-capital explanation :

Foreign firms might be no better than domestic firms at producing and might receive no other special payoff from controlling domestic production, yet be willing to pay more for domestic enterprises simply because they apply a lower discount rate to expected cashflows. This may be referred to as the " cost-of-capital " explanation of FDI.

But the majority of economists studying FDI tend to dismiss cost-of-capital explanations for the following reasons :

First, foreign investors simply seeking a higher return can achieve that aim

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[2] Edward M. Graham and Paul R. Krugman, p.35.

through portfolio investments in securities rather than by the more cumbersome route of corporate direct investment, so that the cost-of-capital view fails to explain why the direct rather than the portfolio route should be chosen.

Second, firms engaging in FDI often finance an important share of the investment locally; it is hard to understand why they would do this if a low cost of capital at home were the motivation for investing in the first place.

Third, FDI among advanced countries typically proceeds in both directions, sometimes in the same industry.[3]

B- Industrial-Organization Explanations :

Industrial-organization theories of FDI can be divided into two categories : those that focus on the internal characteristics of multinational firms, and those that focus on rivalry among such firms.[4]

a- Internal Characteristics :

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[3] Ibid , p.36.

[4] Ibid, p.177.

" The work most often cited as seminal in creating this basis is the 1959 doctoral dissertation of Stephen Hymer, Published posthumously in 1976. Hymer first articulated the now widely accepted notion that a firm whose operations cross national boundaries faces costs that a firm whose operations are limited to one nation does not. These extra costs include those of managing geographically widespread operations and those of dealing with different languages, cultures, technical standards, and customer preferences. Hymer argued that for a firm to overcome the handicaps posed by these extra costs, it must possess internal, firm-specific advantages over its rivals. He speculated that these advantages largely took the form of economies of scale or of superior product technology.[5] A second very influential early work was that by John Dunning (1958). This work was largely empirical in nature. Dunning examined manufacturing operations in the United Kingdom controlled by US-based firms. He found that these operations generally paid higher wages and were characterized by higher rates of labor productivity

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[5] Hymer H. Stephen, The International Operations of National Firms, (Cambridge MIT Press: 1976), pp. 57 - 91.

and new product innovation than their UK-controlled rivals. Dunning's work, although done quite independently of that of Hymer, seemed to confirm many of Hymer's speculations.[6]

Much of the work since Hymer and Dunning has attempted to pin down the firm-specific advantages that drive FDI. Aharoni (1966) noted the importance of imperfect information about markets as a determinant of FDI flows;[7] Vernon (1968,1974) pointed out the linkage between the product cycle in technology and the shift from exports to direct investment among US firms;[8] Kindleberger (1969) noted the role of firm-specific advantages

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[6] John H. Dunning , American Investment in British Manufacturing Industry, (London: George Allen & Unwin), p.50.

[7] Yair Aharoni , The Foreign Investment Decision Process, (Boston : Harvard University Graduate School of Business Administration, 1966), p.26.

[8] Raymond Vernon , "International Investment and International Trade in the Product Cycle", Quarterly Journal of Economics 83, no.1, 1966, pp. 190 - 207.
Raymond Vernon , "Multinational Enterprise and National Security", Adelphi Papers 74, (London : Institute for Strategic Studies: 1971), p.15.
Raymond Vernon , "The Location of Economic Activity", In John H. Dunning ed., Economic Analysis and the Multinational Enterprise, (London : George Allen & Unwin, 1974), p. 58.

other than technology, such as organizational and marketing skills.[9] Caves (1971) summarizes these developments by noting that the advantages possessed by multinational enterprises can include any of a number of intangible assets, including organizational and marketing skills and product and process technologies.[10] Buckley and Casson (1976) suggested a still broader interpretation of the motivations for FDI that has since become more or less the standard point of departure. They observed that for the multinational enterprise to service nonhome-nation markets via direct investment rather than alternative modes of doing business (e.g., exporting or licensing) there must be economies associated with a firm exploiting a market opportunity through internal operations rather than through arm's-length transactions such as the sale of rights to the firm's intangible assets to other firms. These economies might be associated with costs (including opportunity costs) of contract enforcement or maintenance of quality or

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[9] Charles P. Kindleberger , American Business Abroad:Six Lectures on Foreign Direct Investment, (New Haven, CT:Yale University Press: 1969), p.154.

[10] Richard E. Caves , "International Corporations: The Industrial Economics of Foreign Investment", Economica 38, no.141, 1971, pp. 1 - 27.

other standards. Buckley and Casson noted that, where these costs are absent, firms very often do use licensing or franchising as a means of serving international markets.[11]

Dunning (1988) has emphasized that the advantages of internalization must interact with both firm-specific advantages and locational advantages to explain FDI. He also suggests that the reasons for FDI are diverse and thus that no one theory can account for all such investment.[12]

The effort to define the advantages of internalization is ultimately part of the theory of why firms exist. This effort has generated a large literature, which is surveyed by Rugman (1986).[13]

More recent developments have been the attempt to embed theories of FDI in formal models of international trade (Helpman and Krugman, 1985)

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[11] Peter J. Buckley and Mark C. Casson, The Future of Multinational Enterprise, (London: Macmillan: 1976), p.208.

[12] John H. DUNNING , "The Eclectic Paradigm of International Production : A Restatement and Some Possible Extensions", Journal of International Business Studies 19, no.1, 1988, pp. 1 - 31.

[13] Alan M. Rugman , "New Theories of Multinational Enterprises: An Assessment of Internalization Theory", Bulletin of Economic Research 38, no.2, May 1986, pp. 101 - 118.

and technological accumulation theory. The latter postulates that firms have different technological histories, which may critically influence the ability of an individual firm to apply a new technology. This theory helps explain why, for example, a small high-technology firm seeking to be acquired can have greater value to one acquiring firm than to another.[14] This, in turn, can explain why in some cases foreign investors are apparently willing to pay premium prices for such acquisitions(Cantwell 1990).[15]

b- Intraindustry Rivalry :

The possibility that rivalry among firms operating in the same industry, but not necessarily in the same country or countries, can affect FDI behavior was suggested by Hymer both in his doctoral dissertation and in some later work (Hymer and Rowthorne 1970).[16] To some extent rivalry

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[14] Elhanan Helpman & Paul R. Krugman, Market Structure and Foreign Trade, (Cambridge, MA: MIT Press: 1985), pp. 98 - 115.

[15] John Cantwell , "The Technological Competence Theory of International Production and its Implications", University of Reading Department of Economics Discussion Papers in International Investment and Business Studies, series B, vol. 3, no. 149, 1990, pp. 77 - 98.

[16] Stephen H. Hymer and Robert Rowthorne, "Multinational firms and International Oligopoly: The Non-American Challenge", The International

drives FDI in Raymond Vernon's work as well. The same idea appears in an influential book by Seev Hirsch. Knickerbocker (1973) noted a " follow the leader " pattern in the timing of FDI by US firms. He interpreted this phenomenon as a rational response to oligopolistic rivalry.[17] Other studies have detected similar patterns in the overseas activities of non-US firms (Flowers, 1976)[18]. Also, detailed studies of certain industries have confirmed Knickerbocker's findings for US firms. Finally, Graham (1978,1990) suggests that intraindustry FDI may take place as an " exchange of threat ", in which firms invade each others' home markets as part of an oligopolistic rivalry."[19]

Corporation: A Symposium, (Cambridge, MA: MIT Press: 1970), pp. 57 - 91.

[17] Frederick T. Knickerbocker , Oligopolistic Reaction and Multinational Enterprise, (Boston: Harvard University Graduate School of Business Administration, 1973), pp. 150 - 158.

[18] Ed B. Flowers , "Oligopolistic Reactions in European and Canadian Direct Investment in the United States", Journal of International Business Studies 7, no.3, 1976, pp. 43 - 55.

[19] Edward M. Graham , "Transatlantic Investment by Multinational Firms: A Rivalistic Phenomenon?", Journal of Post Keynesian Economics 1, no.1,1978, pp. 82 - 99.

Edward M. GRAHAM , "Exchange of Threat Between Multinational Firms as an Infinitely Repeated Noncooperative Game", International Trade Journal

Aliber (1970,1971) was the first to present arguments relating direct investment. Aliber suggested that the pattern of foreign direct investment could be explained by differences in the cost of capital which are created by exchange-risk premiums.[20]

Heckerman (1972) defines the value of foreign operations as the present discounted value of a foreign income stream. By evaluating local currency flows in real terms, Heckerman found that fluctuations in the terms of trade could result in significant capital gains and losses. Heckerman's results, while meaningful, were constrained by the assumption that real sales levels and the margin between revenues and costs are unaffected by fluctuations in the terms of trade.[21]

Stevens (1972) uses an interesting approach in studying the investment and financing decisions of the multinational firm. Stevens accepts the

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[20] Robert Z. Aliber , "A Theory of Direct Foreign Investment", In International Corporation: a Symposium, (Cambridge, MIT Press: 1970), pp. 17 - 34.

[21] Donald Heckerman , "The Exchange Risks of Foreign Operations", Journal of Business, Jan. 1972, pp. 42 - 48.

Modigliani-Miller theorem which states that under certain restrictive conditions such as the absence of taxes the firms' financial decisions have no influence on its market value. This permits Stevens to simplify the value maximization problem by separating the direct investment and financing decisions.

Stevens assumes that the firm is a value maximizer. The level of foreign investment is solved by setting the marginal revenue product of each asset equal to its shadow price. The indeterminancy in the firms' financing policy is resolved by assuming that the firm minimizes exchange-rate losses on its borrowing while financing the level of real investment required to maximize the firms' market value.[22]

Kohlhagen (1977a) presents a model which allows for domestic production and the exportation of output. Kohlhagen then investigates the effect of a devaluation on the relative profitability of domestic versus foreign production. Kohlhagen proceeds to argue that direct foreign investment is

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[22] Guy V. G. Stevens , "The Effects of Exchange Rate Adjustment on International Investment Comment", The Effects of Exchange Rate Adjustments, (Washington DC: U.S. Printing Office: 1977), pp. 183 - 189.

based on the profitability of foreign production relative to the profitability of domestic production and exportation. Kohlhagen (1977b), in a subsequent paper, further develops the model presented in Kohlhagen (1977a). Kohlhagen is able to show, under a very restrictive set of conditions, that devaluation of the domestic currency will unambiguously favor domestic production and export relative to direct foreign investment and foreign production.[23]

Hartman (1979) uses a portfolio model approach to study domestic investment, direct foreign investment, and foreign borrowing levels in the aggregate. Hartman assumes that individual investors are risk-averse, and the investor therefore requires that in the aggregate firms pursue policies consistent with investor risk-averse preferences. Risk arises from two inseparable sources in the model; the imperfect correlation of returns among countries and the exchange risk arising from foreign-currency-denominated debt. Hartman solves his model for portfolios (domestic investment, direct

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[23] Steven W. Kohlhagen , "The Effects of Exchange Rate Adjustment on International Investment - Comment", The Effects of Exchange Rate Adjustments, Washington DC: U.S. Printing Office, 1977a, pp. 20 - 25.

foreign investment, and foreign borrowing) which lie on the risk-return efficiency frontier. He is then able to study how the optimal levels of the assets contained in the portfolio are influenced by changes in exogenous parameters. The parameters studied include the sensitivity of asset returns to exchange-rate movements, and the level of various forms of income taxation. One result of interest to this study is Hartman's finding that borrowing is preferred at the location where assets are employed. This preference increases as the sensitivity of asset returns to currency movements increases.[24]

Part Two

Experiences in Foreign Direct Investment

The UN Conference on Trade and Development (UNCTAD) reports that the world direct investment recession is over. UNCTAD figures show that the flow of international investment into all countries around the world rose to $194 billion in 1993 from $158 billion in 1992. UNCTAD expects

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[24] David G. Hartman , "Foreign Investment and Finance with Risk", Quarterly Journal of Economics, May 1979, pp. 213 - 232.

inflows to rise in 1994.[25]

Ged Davis, head of investor relations at the multinational Royal Dutch/Shell Group, the multinational with the world's largest foreign assets, says: "With the demise of foreign aid and the rise of direct investment, it is in all countries' interests to demonstrate their friendliness to investors."[26]

Western Europe Countries

France:

Foreign direct investment inflows:

In his introduction to *Doing Business in France* the president of Invest in France, Henry Martre, says: "France has become one of Europe's leading countries for inward investment from abroad". In the five years up to 1992, investment inflows rose more than 150% to $21,843, the world's largest inflow. These investments make up 30% of exports. Investment stock was

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[25] " Guide to Direct Investment 1994", Euromoney Supplement, September 1994, p. 384.

[26] Ibid, p. 384.

$119.2 billion in 1992, putting France fourth after the US, the UK and Germany. Most inward investment in 1993 involved the acquisition of ailing companies. Direct investment flows into electronics, computers and telecommunications have complemented substantial investment in traditional areas such as automobiles and construction. Four regions accounted for 40% of new or saved enterprises and 56% of jobs.

Investment Regulations:

Foreigners have been allowed to create new companies in France without restrictions since 1988. They are also free to acquire French companies with a turnover of less than Ffr500 million ($95 million) provided the purchase price is below Ffr50 million. If the acquisition involves one-third of capital or voting rights in an unquoted company or 20% in a quoted company, EU investors need only declare the purchase in advance, while non-EU investors must get prior authorization. Authorization is assumed to have been given if the MOF does not respond within a month. Less than 0.5% of requests are refused. The French government abolished exchange controls on January 1 1990.

Investment Incentives:

The regional development agency DATAR offers cash grants of up to 25% of start up costs according to the number of jobs created and the location, eventual turnover and size of the investment. The government is keen to encourage investment in the west, south-west, north-east and in central parts of France.

Taxation:

Corporate tax rates have been 33.33% since January 1993, down from 50% in 1986. Companies situated abroad are exempt from French tax. Companies can also receive tax credit of up to 50% on the dividends paid. VAT is levied at a standard 18.6%, although it is only a cost for the end-user. Non-residents are taxed on the income earned in France. For residents, tax is based on progressive rates up to 56%.

Developments in Direct Investment:

New enterprises accounted for 40% of jobs created by direct investment in France.[27]

[27] Ibid, p. 390.

Spain:

Foreign direct investment inflows:

Spain has been the recipient of accelerating flows of investment since the mid-1980s. Annual investment flows averaged $2,528 million between 1982 and 1987, reaching a peak of $13,841 million in 1990. In 1993, inflows were about $8,000 million. The trade and tourism ministry considers Spain's most attractive sectors to be automobiles, biotechnology, electronics, leisure, health-care and food processing industries.

Investment regulations:

Exchange controls have been lifted since the Royal Decree of 1991, giving greater freedom to transactions and operations. After 1992, prior authorization has been generally no longer required for investments. However, still exist for non-EU residents and governments investing in specific business sectors. Residents of certain designated countries deemed by Spain to be tax havens are also subject to greater controls. Prior clearance is required where the foreign holding is above 50% and the amount of investment exceeds Pta500 million ($16 million).

Investment incentives:

Spain offers subsidies for investment expenditures in four sectors: extractive and processing industries, food processing and fish farming, industrial support services, and specific touristic facilities. Such subsidies are given according to investment purpose, and apply to 83% of Spanish territory. In most parts, the subsidy is 50% of the investment.

Taxation:

Spain's corporate tax rate is 35%. Foreign investors can benefit from tax credits; for investment involving significant research and development, credit can reach 45% of the investment. There is also a 25% withholding tax on the remitted profits of non-residents doing business through a permanent establishment in Spain. An additional net worth tax , ranging from 0.2% to 2.5%, applies to worldwide assets in the case of residents and to Spanish property and rights for non-residents. The VAT which came into force in January 1993 is 15% with reduced rates of 6% and 3%.

Developments in direct investment:

Philip Morris, Nestle' and Kellogg have all established industrial

presence in Spain. In July 1993, RJR Nabisco bought 50% of biscuit manufacturer Royal Brands for Pta17.2 billion. In pharmaceuticals, the biggest project is the Pta18 billion plan by Boehringer Ingelheim to build a production plant in Barcelona. [28]

Bermuda:

Foreign direct investment inflows:

Although Bermuda has a population of only 60,000 and a workforce of 35,000, net direct inflows totalled $3,256 million in 1992. This contributed to a total investment stock of $19,595 million in 1992. The island is a center for international business, shipping and the oil trade. Bermuda has the largest captive insurance center in the world - there are about 1,300 insurance companies.

Investment regulations:

Most of Bermuda's international companies are exempted companies which may only carry out business that is external to Bermuda. An exempted

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[28] Ibid, p.392.

company must have a minimum share capital of $12,000. This rises to $120,000 for an insurance company and to $250,000 for a life insurance company.

Investment incentives:

The main incentives to set up business in Bermuda are freedom from taxes and lack of government interference. With the exception of insurance companies, businesses do not have to file financial data with the authorities. The Bermudian government encourages foreign investment in entities that do not compete with local businesses.

Taxation:

Bermuda imposes no tax on incomes, dividends and capital gains of companies or individuals. There is also no withholding tax.[29]

Eastern Europe Countries:

Lithuania:

Foreign direct investment inflows:

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[29] Ibid, p. 398.

In 1993, capital inflows to Lithuania were Lit 94 million ($74 million). The economics ministry suggests its most attractive sectors for investors are hotels, trade, food, timber products and light industry.

Investment regulations:

Encouragement of foreign ventures is based on the Law on Foreign Investments which was amended in February 1992. A license is needed but there is no restriction on the level of investment allowed except in areas such as defense, communications, alcohol production and gambling.

Investment incentives:

Since January 1994, Lithuania has offered 50% tax reductions on the proportion of profit accruing to foreign investors for the first six years of an investment period. Repatriated income is totally tax exempt, as are dividends to foreign investors.

Taxation:

The basic rate of corporation tax is 29%. Profits due from a foreign investor's share of an enterprise are exempt from between 50% and 70% of corporate tax. VAT is levied at a basic rate of 18%. Foreign nationals are

also subject to a progressive income tax which rises from 10% to 33%.[30]

American Countries:

Bolivia:

Foreign direct investment inflows:

Flows into Bolivia have been swelling rapidly, climbing by 93% in 1991 and 79% in 1992. Last year Bolivia attracted direct investment of $129 million. This figure is expected to double in 1994 to $250 million.

Investment regulations:

Bolivia has dropped its insistence that most foreign companies act in joint production with local companies. The state permits wholly foreign-owned companies to operate and there are no exchange controls.

Taxation:

Bolivia intends to introduce legislation in 1994 guaranteeing tax stability. Corporate tax varies from 10% to a maximum 13%. Investors establishing companies also pay a tax of between 1% and 2% of the capital

[30] Ibid, p.396.

value of their Bolivian entity. VAT is levied at 13%.

Investment opportunities:

Bolivia is one of only two landlocked countries in the Americas. National Secretary for Capitalization and Investment Ramiro Ortega Landa says investors will be drawn into the capitalization programme because "Bolivia is a very underdeveloped market and thus offers large potential". Bolivia has about 5.2 trillion cubic feet of proven gas reserves. It hopes to attract more international investors with the vision of Bolivia becoming the gas producing center of "the southern cone".[31]

[31] Ibid, p. 406.

CHAPTER III

PROCEDURES AND METHODOLOGY

POPULATION AND SAMPLE SELECTION

The population of this study consist of hundred seventy three countries that have compiled data by UNDP and Euromoney.

The sample selected consist of 96 countries for which we have comparable data.

DEPENDENT & INDEPENDENT VARIABLES

The 96 countries in this piece of research are measured in five variables as shown below in Table 1.

Country	FDI 88-92	Eco-Perf	Risk-Pol	Gvt-Adm	Gvt-Inc
Argentina	10,629.00	14.25	27.90	8.00	8.00
Australia	32,398	21.26	44.75	4.00	12.00
Austria	29,27	22.44	42.55	4.00	6.00
Bahamas	53.00	15.80	34.80	12.00	6.00
Bahrain	384.00	17.26	39.15	20.00	22.00
Barbados	53.00	13.33	27.80	12.00	18.00
Belarus	7.00	5.78	13.30	14.00	12.00

Belgium	38,744.00	20.64	46.80	20.00	12.00
Belize	81.00	12.57	24.15	4.00	16.00
Bolivia	138.00	8.25	21.30	10.00	12.00
Botswana	221.00	14.92	30.20	14.00	18.00
Brazil	7,563.00	12.50	23.10	12.00	12.00
Brunei	(5.00)	19.31	42.85	4.00	16.00
Bulgaria	102.00	10.09	15.60	18.00	14.00
Canada	28,408.00	21.80	48.15	16.00	12.00
Chile	1,874.00	17.75	36.95	10.00	10.00
China	25,596.00	21.14	37.10	18.00	18.00
Colombia	2,526.00	14.91	29.15	20.00	15.00
CostaRica	784.00	12.04	26.50	16.00	18.00
Cyprus	451.00	19.26	36.00	8.00	12.00
CzechRep	1,570.00	17.48	35.65	12.00	8.00
Denmark	5,295.00	22.63	47.80	18.00	12.00
Domincan	673.00	9.46	19.50	10.00	10.00
Ecuador	407.00	10.49	19.50	4.00	8.00
ElSalvdor	77.00	9.84	17.10	12.00	14.00
Estonia	58.00	12.18	20.65	12.00	14.00
Fiji	158.00	13.93	28.50	14.00	18.00
Finland	1,774.00	20.48	41.85	14.00	16.00
France	68,975.00	21.53	48.75	14.00	12.00

Gabon	38.00	10.41	15.05	8.00	10.00
Germany	34,770.00	20.53	49.40	18.00	12.00
Ghana	77.00	12.83	21.90	8.00	14.00
Greece	4,943.00	15.29	33.60	4.00	8.00
Guatmala	638.00	10.45	17.80	14.00	16.00
Honduras	247.00	8.25	12.80	12.00	15.00
HonKong	7,888.00	21.50	43.70	12.00	8.00
Hungary	2,941.00	15.46	29.85	16.00	22.00
Iceland	16.00	14.99	40.40	10.00	6.00
India	864.00	16.69	30.75	16.00	16.00
Indonesia	5,607.00	18.71	34.20	18.00	16.00
Ireland	475.00	20.24	43.65	18.00	14.00
Israel	944.00	17.15	35.70	4.00	16.00
Italy	20,896.00	18.38	43.15	4.00	8.00
Jamaica	397.00	11.11	21.00	12.00	16.00
Japan	4,270.00	21.65	50.00	14.00	12.00
Kazakstan	100.00	7.36	14.85	8.00	14.00
Kenya	145.00	9.93	21.55	8.00	12.00
Korea	4,010.00	21.57	44.70	16.00	18.00
Kuwait	(20.00)	16.23	34.70	10.00	10.00
Latvia	14.00	9.96	17.15	16.00	14.00
Lesotho	62.00	8.18	17.75	12.00	16.00

Lithuania	10.00	9.75	20.00	16.00	18.00
Luxmborg	2,031.00	23.94	45.65	4.00	12.00
Malaysia	12,910.00	22.78	41.85	20.00	22.00
Malta	177.00	19.08	40.35	16.00	18.00
Mauritius	134.00	12.50	20.00	18.00	20.00
Mexico	18,391.00	15.51	31.15	10.00	12.00
Mongolia	27.00	3.33	13.80	14.00	16.00
Namibia	195.00	13.17	18.45	18.00	20.00
Nethrland	36,725.00	21.31	50.00	14.00	8.00
N.Zealand	4,312.00	19.79	48.15	16.00	16.00
Nigeria	4,456.00	6.91	10.00	14.00	12.00
Norway	3,300.00	22.96	40.40	4.00	10.00
Pakistan	1,246.00	12.24	24.15	16.00	18.00
Panama	(74.00)	10.07	22.85	8.00	14.00
Pap.Ginea	1,382.00	11.21	23.00	18.00	20.00
Paraguay	220.00	13.40	22.75	10.00	12.00
Peru	246.00	11.99	19.45	20.00	18.00
Philipine	2,801.00	14.25	26.05	10.00	16.00
Poland	1,084.00	16.08	26.45	8.00	14.00
Portugal	9,590.00	18.64	41.15	20.00	14.00
Qatar	30.00	16.73	37.80	12.00	12.00
Romania	117.00	10.10	20.85	14.00	12.00

Russia	700.00	7.75	10.55	12.00	12.00
SaudiAra	964.00	15.10	34.76	14.00	18.00
Singapore	21,721.00	25.00	48.65	16.00	20.00
Slovakia	597.00	10.68	24.25	12.00	8.00
Slovenia	111.00	13.59	27.50	8.00	14.00
S. Africa	107.00	15.11	28.10	12.00	18.00
Spain	47,851.00	20.84	47.50	20.00	16.00
Sri Lanka	286.00	14.03	25.60	16.00	20.00
Sweden	11,052.00	20.32	45.90	10.00	10.00
Switzer	12,404.00	22.89	46.25	4.00	10.00
Taiwan	6,043.00	23.16	46.75	16.00	14.00
Thailand	9,454.00	21.42	36.75	8.00	14.00
Trin&Tob	668.00	12.21	29.40	10.00	16.00
Turkey	3,355.00	12.64	24.40	18.00	12.00
Ukraine	200.00	6.59	9.30	12.00	18.00
UAE	260.00	17.41	41.60	6.00	16.00
UK	118,884	21.67	48.15	8.00	10.00
USA	196,620	22.93	50.00	14.00	10.00
Uruguay	172.00	12.42	27.15	14.00	12.00
Uzbeksta	40.00	7.80	10.70	0.00	14.00
Venzuela	3,298.00	12.85	19.45	18.00	18.00
Vietnam	60.00	15.42	23.20	10.00	14.00

Zimbabw	(4.00)	11.81	21.80	4.00	18.00

CONCEPTUAL FRAMEWORK FOR ANALYZING DATA

To answer the research questions that were posed in Chapter I , the researcher is going to use two statistical techniques:

1- Percentage Analysis and Graphical Representation of Data will be used to answer the research question about major characteristic of the selected countries.

2- Multiple Regression Analysis will be used to test the relative effect of FDI on Economic Performance holding the effect of other variables constant.

CHAPTER IV

Findings Of The Study

This chapter shows the findings pertinent to the research questions presented initially in the first chapter. These questions are:

1- What are the major characteristics of countries of the selected sample for the study?

2- What is the relative importance of FDI on the economic performance holding government regulations, government administrations, government incentives constant?

Major Characteristics of the Selected Sample

The selected sample of the 96 countries is described according to the following variables:

1. --------> FDI 88_92: cumulative FDI inflows.

2. --------> Eco_perf: economic performance.

3. --------> Risk_pol: political risk.

4. --------> Gvt_adm: government administrations.

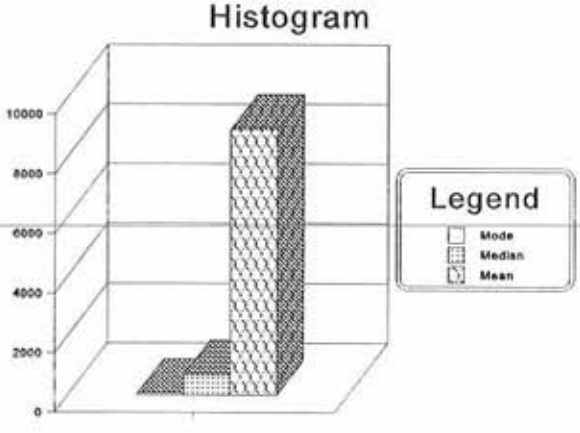
5. --------> Gvt_inc: government incentives.

Table (2) exhibits the basic statistics for the variables of the study:

TABLE -2-
The Basic Statistics for the Variables

Variable	Mean	Std dev	Skewness
Economic Perf.	15.308	5.067	-0.026
Cum. FDI 88-92	8910.374	25375.980	5.444
Govern. Adm.	12.229	4.889	-0.325
Govern. Inc.	13.958	3.814	-0.027
Pol. Risk	30.969	11.816	0.054

Figure (1) shows that the chart is skewed to the left which means that the majority of countries have low average FDI.



Regression Analysis

Regression analysis is used in answering the second research question

that was posed in Chapter I as follows:

What is the relative importance of FDI on the economic performance holding the effect of government regulations, government administrations, government incentives constant ?

Table (3) shows the multiple regression correlation.

TABLE (3)
* * * * M U L T I P L E R E G R E S S I O N * * * *

Correlation, 1-tailed Sig:

	Eco_Perf	Gvt_Adm	Gvt_Inc	LogFDI	Risk_Pol
Eco_Perf	1.000	0.050 0.318	-0.126 0.115	0.702 0.000	0.944 0.000
Gvt_Adm	0.050 0.318	1.000	0.498 0.000	0.112 0.143	0.067 0.262
Gvt_Inc	-0.126 0.115	0.498 0.000	1.000	-0.169 0.054	-0.199 0.029
LogFDI	0.702 0.000	0.112 0.143	-0.169 0.054	1.000	0.680 0.000
Risk_Pol	0.944 0.000	0.067 0.262	-0.199 0.029	0.680 0.000	1.000

In this table the researcher can deduce that there exists a good correlation between cumulative FDI inflows and economic performance. Moreover, the logical interpretation for the negative sign between Economic

Performance and Government incentives is that governments up till now are not providing high incentives to encourage foreign investments.

----- **Table (4)** ----------

* * * * M U L T I P L E R E G R E S S I O N * * * *

Equation Number 1 Dependent Variable.. ECO_PERF

Variables(s) Entered on Step Number

1.. RISK_POL
2.. GVT_ADM
3.. GVT_INC
4.. LOGFDI

Multiple R	0.95255
R Square	0.90735
Adjusted R Square	0.90310
Standard Error	1.59270

Analysis of Variance

	DF	Sum of Squares	Mean Square
Regression	4	2161.43505	540.35876
Residual	87	220.69302	2.53670

F = 213.01631 Signif F = 0.0000

----------Variables in the Equation----------

Variable	B	SE B	Beta	T	Sig T
Gvt-Adm	-0.083687	0.041187	-0.078705	-2.032	0.0452
Gvt-Inc	0.146588	0.052307	0.110173	2.802	0.0063
LogFDI	0.636565	0.223290	0.128222	2.851	0.0054
Risk_Pol	0.379178	0.019248	0.884361	19.700	0.000
(Constant)	0.705943	0.892440		0.791	0.4311

Table (4) reveals that the variable is significant in explaining 90% of the variation at a zero level significance. It is noticed also that the cumulative FDI inflows variable is a significant variable in determining economic performance.

Moreover, **Figure (2)** shows that among the OECD countries, USA has the largest amount of foreign investments, followed by United Kingdom,France and Spain.

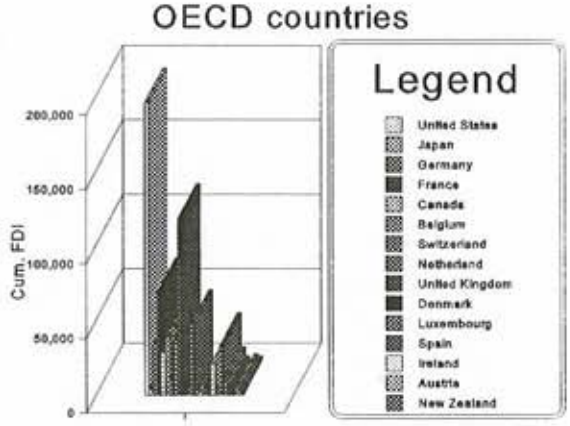
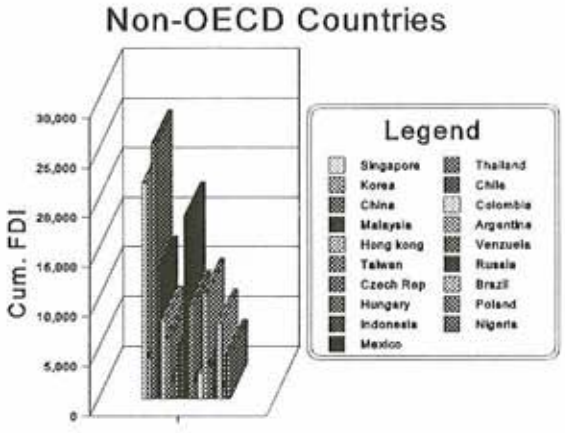


Figure (3) shows that among the Non-OECD countries, China comes first, followed by Singapore, Mexico and Malaysia.



In **figure (4)**, the countries are divided according to regions: offshore, Asia Pacific, Central & South America, Middle East & North Africa, Eastern Europe and The Former Soviet Union and Sub-Saharan Africa. It is clear that offshore countries are capturing the highest foreign investments.

Offshore countries: Bermuda, Malta, Cyprus, Bahamas, Seychelles, Maldives.

Asia Pacific: India, Brunei, Pakistan, Bangladesh, Fiji, Philippines, Papua

New Guinea, Sri Lanka, Macau, Mongolia, Vietnam.

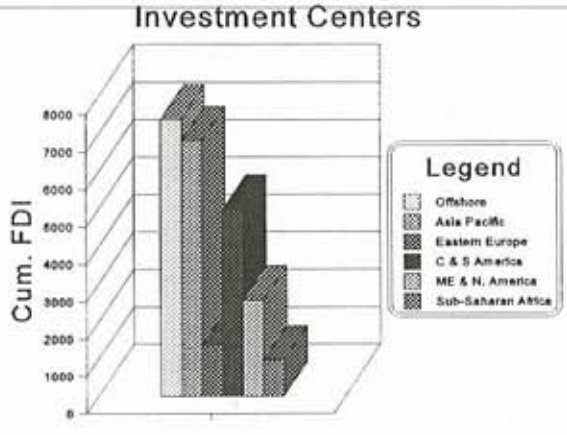
Eastern Europe: Slovenia, Slovakia, Bulgaria, Lithuania, Romania, Ukraine, Estonia, Latvia, Belarus, Kazakhstan, Croatia, Uzbekstan.

Central & South America: Barbados, Costarica, Uruguay, Peru, Trinidad & Tobago, Antigua & Barbuda, Panama, Guatemala, Jamaica, Paraguay, Dominican, Belize, Ecuador, Honduras, Puerto Rico, El Salvador, Bolivia.

Middle East & North Africa: Israel, Bahrain, UAE, Saudi Arabia, Qatar, Kuwait.

Sub-Saharan Africa: South Africa, Botswana, Mauritius, Namibia, Lesotho, Zimbabwe, Ghana, Gabon, Kenya.

OECD: Organization for Economic Cooperation and Development.



CHAPTER V

Conclusion and Recommendations

Conclusion

The genuine purpose of this study was to determine the effect of FDI on the economic performance for developed and developing countries. It was very important to shed the light on the global debt crisis that emerged in the summer of 1982 and to mention that this crisis was the direct reason for the birth of FDI as an alternative for moving the wheel of economy in any country.

The data compiled by UNDP and Euromoney from which we selected 96 countries in order to test the significance of the given variables came to fill the gap between theory and the empirical evidence.

The regression analysis showed clearly that FDI has a very important effect on the economic performance.

Furthermore, countries that had undergone the experience of FDI had proven that foreign investments created job employment due to the existence of companies and benefited from the technologies brought by the outsiders as well as decreasing their liability to debt.

Recommendations

Developed and developing countries are all invited to demonstrate their friendliness to investors by providing good investment incentives by lowering tax rates and offering subsidies for investment expenditures as well as providing encouraging regulations like lifting exchange controls and giving freedom to transactions and operations. Because FDI will be the water that quenches the thirst of the desert !

Moreover, a recommendation can be offered to the Lebanese Government to invite foreign investors to Lebanon by formulating policies that attract these investors who always search for high incentives. So that Lebanon will stop accumulating debt and paying interest.

In addition, the researcher recommends for future research that FDI inflows for specific years and not cumulative ones could be taken and tested.

Appendix

Methodology :

The countries surveyed in this research are divided into eight regional groups : **OECD members, a non-OECD league of investment leaders, offshore centers, sub-Saharan Africa, South and Central America, Asia-Pacific, Eastern Europe and the former Soviet Union, and the Middle East and North Africa**. Each country is given a score for comparison with the other countries in its group, but **cross-regional comparison is not valid**. For each regional grouping, the assessment method uses a number of indicators, dividing broadly into five categories **(economic strength, markets, resources, risk, government).** Each indicator is scored and converted into the weighted scores as follows : the highest figure in each category receives the full mark for the weighting. The lowest receives zero. The score for the remaining figures is calculated proportionately according to the formula :

Final score = (weighting / (maximum figure - minimum figure)) * (figure - minimum figure).

The exceptions to this rule are that, in the case of inflation, the indicators

are scored on their logarithmic value (negative figures converted into positive), as is the labor force figure for OECD countries. In addition, for cost of labor, the highest figure merited zero and the lowest the full weighting mark. The final score is a percentage of the maximum possible score for all categories. ***Economic strength:*** The **economic forecast** indicator is taken from the *Euromoney Global Economic Projections 1993-94*, the result of a bi-annual poll of economists from leading banks, academic institutions and economic think-tanks, and is published in the March and September issues of *Euromoney* magazine. The analysts were asked to score countries in comparison both with each other and with previous years. The world's fastest- growing economy in an ideal year would score 25, the worst zero in a disastrous year. All factors have been taken into account, including: sustained economic growth, monetary stability, current account and budget surplus/deficit, unemployment and structural imbalances. The figure presented is the aggregated result for 1993 and 1994.

Markets: Cumulative FDI inflows are cumulative foreign direct investment inflows as measured in each reporting countries' balance of

payments statistics and presented by the IMF in its *International Financial Statistics* report. **Regional GNP** assesses the country's catchment area in terms of the GNPs of all the economies within 500 kilometers of its borders. The measure considered only the main land mass of the nation, so dependent territories and, in the case of the US, Hawaii and Alaska were not taken into account. *Resources:* **Labor costs per hour**, measure the average cost of labor in the manufacturing sector. This includes all payments made to the workers as well as mandatory insurance programmes. The UN HDI (human development index) is the yearly figure published in the UNDP Human Development Report. The index is " a composite measure of human development containing indicators representing three equally-weighted dimensions of human development - longevity (life expectancy at birth), knowledge (adult literacy and mean years of schooling), and income (purchasing power parity dollars per capita) ".

Risk: **Political risk** is taken from *Euromoney's* country risk rankings, published bi-annually in March and September. The figures presented are the results of a poll of political risk analysts, risk insurance brokers and

bank credit officers. A score of 50 indicates zero political risk. **Credit risk** is an aggregate of debt indicators, access to bank lending, access to short-term finance, access to capital markets, discount on forfeiting, credit ratings and debt in default or rescheduled. A score of 50 indicates zero perceived credit risk.

Government: Scores in this section are derived from Euromoney's survey of investment agencies around the world. Questionnaires were faxed or posted to 163 countries. For those who did not reply, information was found fro other sources, including the commercial sections of diplomatic missions and professional consultancies. The **regulations** category scores countries on the following criteria: possible foreign ownership, both with and without government approval (up to 10 marks each), permissible repatriation of profits and the proceeds of sale or liquidation (up to 10 marks each), and whether or not the country is a signatory to four key multilateral conventions (up to 10 marks). These conventions are the convention on the settlement of investment disputes between states and nationals of other states [Washington], the convention establishing the Multilateral Investment Guarantee Agency [MIGA], New York

convention on the recognition and enforcement of foreign arbitral awards, and the Paris convention for the protection of industrial property. The maximum score is therefore 50. The **incentives** category is scored on an analysis of fiscal and non-fiscal incentives available to the foreign investor. The maximum score is 30 based on a consideration of :

(i) the existence and conditions of tax holidays ;

(ii) concessions on import and export duties, sales tax , withholding tax, contributions to mandatory insurance programmes;

(iii) grants and loans for investment, research and development, and training;

(iv) the establishment of special economic zones.

The **administration** score assesses the performance of the agency responsible for promoting, regulating or assisting direct investment projects. The maximum score is 20. Four marks are given if the agency is so-called "one-stop" or "single window" agency (four marks are awarded automatically if no government approval is required), four marks are given for providing relevant information, six marks for a questionnaire reply and the remainder given for the fullness and quality of the response.

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