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Can FDI Be Bad for Growth?

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Abstract: We find a curious negative casual relationship between foreign direct investment (FDI) and total factor productivity growth (TFPG) across the world for the period 1996-2009. The relationship is robust to specifications in which we instrument for FDI using lagged values and geography variables as well as when we control for country and year fixed effects, human capital, the size of government, and other country differences. We hypothesize that not all FDI are the same as channels for technology transfer. We find that higher natural resource extraction accounts for the negative relationship between FDI and TFPG. For countries with no natural resource exports, 10% higher FDI causes 0.7-1.9% faster TFPG. The same 10% higher FDI, however, in countries with 6% higher natural resource exports reduces TFPG by the same amount. These findings have important implications for the middle-income trap and the rise in FDI for natural resource extraction. As an illustrative example, in Vietnam from 2003-2009, FDI in mining and quarrying grew at 135% per year while TFPG in that sector averaged −3%. In manufacturing, FDI grew at only 26% per year while TFPG averaged 24%.

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