Chapter 7
Foreign Direct Investment (FDI) Indexes:
Relevance for Emerging Economies

J. Zambujal-Oliveira
University of Madeira, Portugal

José Pestana-Amaral
Instituto Superior Técnico, Portugal

ABSTRACT

As the foreign direct investment (FDI) attractiveness indexes constitute one of the decision tools for governments' politics, it is relevant to assess the Groh and Wich Index (GWI). The main purpose is to verify the capacity of this index to replicate the phenomena of inflow FDI. The index analysis process included reviewing literature and detecting weaknesses on theoretical frameworks and in the selection of basic indicators. Multivariate analysis, applied to a sample of economies, showed evidence that some composite indicators of the GWI have shortages of concordance between simple indicators. Apart from showing that FDI attractiveness index of Groh and Wich does not convey the progress of inflow FDI, the study demonstrates that a FDI attractiveness index built to advanced economies can hardly be employed to developing economies without significant changes to the basic indicators.

INTRODUCTION

The study of Foreign Direct Investment (FDI) has been assuming a relevant important role in the sustainable development of the countries, in result of being one of the least volatile sources of international investment for host countries and the most dependable source of foreign investment for developing countries. The relevant issue for policy makers in countries starving capital concerns the determinants of FDI attraction (Moosa & Cardak, 2006). To make this task easier, there has been created some knowledge aggregators that includes composite indicators. One of those aggregators is the one authored by Groh and Wich (2009), who constructed an FDI attractiveness index that captures the business attractiveness

of more than 100 countries. The task of this chapter corresponds to appraise the consistency of Groh and Wich's (2009) index on describing the phenomenon of business attractiveness.

Some of the benefits of the positive impact of FDI correspond to technology transfer, introduction of new production processes and productivity gains (Barros, 2009). Despite the profuse literature there is a need to rationalise the knowledge about the factors of FDI attraction. Until now, there has been an inability to determine, based on complete data collected, the FDI attractiveness in a given country (Teixeira & Tavares-Lehmann, 2007). To improve this scenario, some authors, as Groh and Wich (2009) developed FDI attractiveness indexes able to rank 127 countries. Therefore, it is very useful evaluating the consistency of the Groh and Wich (2009) to formally describe the FDI attractiveness phenomenon.

Our study should consider the Organization for Economic Cooperation and Development (2008) considering its operational knowledge on how FDI should be measured and its global standards for FDI statistics. FDI is a key element for quick engagement and international economic integration and provides the means to create direct links, stable and long-lasting between two economies. A right policy environment can serve as an important vehicle for local development and can also help to improve the competitiveness of both sides (country of origin and the host country of FDI). FDI particularly encourages the transfer of technology and know-how between economies and provides an opportunity for the economy of the country of origin to promote its products more broadly in the international market (Amaral, 2013).

The global flow of FDI has grown over the last 30 years and continues to play a primary role in production activities of developed countries which captured roughly 75% in 2008 of the global FDI flows (UNCTAD, 2008). Recently, UNCTAD (2012) revealed that the percentage of total FDI incoming flow absorbed by the developing countries has improved by then. The evidence of a substantial FDI growth in recent years reflect an intensification in the number of transactions, and in its value, and can be interpreted as an entrepreneurial purpose to diversify businesses across economies and industrial sectors OECD (2005, 2008). Multinational enterprises (MNE) are traditionally the major players in each FDI transaction. This development has coincided with the increasing of the MNE's propensity to participate in the international market. The MNEs appear to be the main players in FDI transactions, resulting this role from the growing propensity of the MNEs to act as global market players (Amaral, 2013).

The creation of composite indicators that associate several factors is a frequently solution employed to integrate these factors. Extensively used indexes are the Global Competitiveness Index of World Economic Forum, the Ease of Doing Business Index (EDBI) and the Worldwide Governance Indicators, both coming from the World Bank. The basic assembly of these indexes is often done recurring to methodologies with weighted indicators, adopting often an equal weight for all the indicators (Amaral, 2013).

To create that kind of index, Nardo et al. (2005) explains all the steps that should be taken during the process, as the assortment of sub-indicators, the treatment of missing values, the selection of the integration model and the indicators' weights. Even the fulfilment of all the steps, along with a diligent process of information's recovery can origin distorted or fragile policy conclusions. In that sense, the considerations made by Pinheiro-Alves and Zambujal-Oliveira (2012) on the consistency and validity of Ease of Doing Business Index (EDBI) are an excellent example how the choice of the data sets that represent sub-indicators and the index structure remain questionable.

Groh and Wich (2009) grounded its index structure on a set of literature that describe the FDI attractiveness relationship with their determinants. Our main propose consists in validating this the quality of the relationship implemented between the determinants the FDI, considering the possibility of existing missing relevant indicators. For that reason, our task is trying to replicate (in an initial phase and as much as possible) the Groh and Wich (2009) process, employing the same or similar databases

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