

## **A STUDY OF FDI INFLOWS AT WORLD LEVEL: AN ANALYSIS OF TRENDS**

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*Dr. Vinod Kumar*  
*Assistant Professor, Sri Venkateswara College*  
*University of Delhi*  
*E-mail: drvinodtoor@gmail.com*

### **ABSTRACT**

It is generally acknowledged that FDI produces economic benefits to the recipient countries in terms of capital, foreign exchange, technology, competition and by enhancing access to foreign markets. FDI also plays significant role in achieving rapid economic growth in the developing countries by bridging the gap between domestic savings and investment and to import the latest technology and management know-how from developed countries. The present study is an attempt to analyze FDI inflows at global level for a period of 1991 to 2010. It has been found that FDI inflows have increased at global level as a whole due to globalization which has created hunger for foreign capital in the form of FDI for both developed and developing countries to compete in the international competitive market through investment of FDI in profitable opportunities in their domestic market.

**Keywords:** Foreign Direct Investment, MNCs, MNEs, UNCTAD, Globalization

### **INTRODUCTION**

The growth of international production is driven by economic and technological factors, which is facilitated by world-wide liberalization of trade policies and Foreign Direct Investment (FDI). Globalization offers an unprecedented opportunity for developing countries to achieve faster economic growth through international trade and investment. During 1970s, international trade grew more rapidly than FDI and thus, international trade was the most significant international

economic activity. This situation changed dramatically during 1980s, when world FDI flow started to increase sharply (Sridharan, Vijaykumar and Chandra Sekhara Rao, 2009). Beginning in the mid-1980s, world FDI flows increased rapidly with a growing number of multinational enterprises (MNEs) as the engine of the increased international economic activities. Both industrialized and developing countries are becoming more receptive to FDI inflows such that a majority of FDI policy changes in these countries are in the direction of more liberalization of FDI inflows (UNCTAD, 1992; Kim and Seo, 2003).

Although FDI flows and stocks are concentrated mostly in Industrialized countries (Lucas, 1990), developing countries, especially in the Asia-Pacific region, recently showed a noticeable increase in their absorption of world FDI flows (UNCTAD, 1992; 1995). Thus, FDI in the recent period has become the principal source for external capital for many developing countries, particularly in Asia.

## **REVIEW OF LITERATURE**

As the cursory review of FDI literature indicates that most of the empirical studies in this area have concentrated on assessing the determinants that induce multinational corporations (MNCs) to invest in a foreign country. Previous empirical studies on the determinants of FDI in less developed countries have emphasized the role of economic environment and liberalization policies in the host countries to attract foreign investment. In early empirical studies analyzed the FDI were, Basi (1966), Kolde (1968) and Wilkins (1970), whereas FDI in Australia was examined by Brash (1966), FDI in New Zealand by Deane (1970), FDI in Scotland by Forsyth (1972). These studies focused on variety of factors including marketing factors, trade barriers, costs factors and investment climate. The consensus is that marketing factors, in particular, market size, market growth and maintaining market share but also dissatisfaction with existing market arrangements were the main determinants of FDI. However, cost factors, especially the availability of labour and raw material, lower production costs and financial inducements by the government, were seen as equally important variables of FDI.

Howard and Banik (2001) explored determinants of private foreign direct investment and explain the variables in terms of 'domestic pull' and 'external push' factors. The market size and gross domestic investment are considered as domestic pull factors and exchange rate and degree of openness are considered as the push factors. The analysis has revealed that the ratio of exports to GDP was the only economic determinant of FDI. Foreign investors have been found attracted because of the strategic geographical position of some countries and the prospect of marketing their products to a global market.

Faeth (2005) examined the determinants of FDI inflows like market size, factor costs, transport costs and protection, risk factors, policy variables and other variables based on a number of different theoretical models in Australia. It was found that FDI driven by long term considerations and its determinants could not be fully explained by any single theoretical model. Exchange rate appreciation discouraged FDI in the medium-term, but had a positive long term effect, indicating that FDI is encouraged by a sound economic environment. There was, however, no evidence that lower corporate tax rates increased FDI inflows.

Rehman et al. (2011) investigated empirically the effects of infrastructure availability on FDI inflows in a developing economy like Pakistan by employing time series data from 1975 to 2008 and by applying Autoregressive Distributive Lag (ARDL) approach to cointegration. The study found that the significant positive impact in short and long run of infrastructure on FDI inflows in Pakistan. In short run, one per cent increase in infrastructure results in uplifting FDI by 1.03 per cent and in long run, one per cent increase in infrastructure enhances FDI inflows by 1.31 per cent. Kumar and Dhingra (2011) concluded that FDI inflows have shown significant growth in the post liberalization period. The compound annual growth rate of actual FDI inflows during this period was 29.56 per cent. The analysis of structure of FDI in India reveals that there definitely has been a shift in favor of service sector and a steep fall in the share of manufacturing sector in post-liberalization era. Singla (2011) examined the determinants of FDI inflows in India from 1993 to 2010 by using correlation and multiple regression analysis. The findings revealed that

FDI inflows depend on stock market, index of industrial production (IIP), gross domestic product (GDP) and foreign institutional investors (FIIs) net investment. On the other hand, exchange rate and foreign exchange reserves do not have any significant effect on FDI inflows in India.

### **OBJECTIVE & METHODOLOGY OF THE STUDY**

The main objective of the study is to analyze the emerging dimension of FDI at global level. The present study is based on secondary time series data ranging from 1991 to 2011 i.e. 20 years. Further, the study period is sub-divided into four parts and each part consists of five years to make comparison of time series data. Data used in this study have been collected from World Investment Report (various issues), For the purpose of analysis, simple average, percentage to point, and annual percentage change in comparison to previous year have been used. For presentation of data, tables are used.

### **ANALYSIS & INTERPRETATION**

#### **1991-95**

Table 1 reveals that world FDI inflows rose by nearly 8 per cent in 1992 and in absolute terms, increased from \$154073 million in 1991 to \$165881 million. The ratio of FDI inflows to Gross Domestic Product (GDP) was 0.66 per cent in 1991 and 0.67 per cent in 1992 (Table 2) and the ratio of FDI inflows to Gross Fixed Capital Formation (GFCF) was 2.99 per cent in 1991 and 3.06 per cent in 1992 (Table 3) respectively. Table 1 reveals that in 1993, world FDI inflows maintained growth momentum and reached to \$223316 million (35 per cent growth rate achieved as compared to 1992). FDI inflows as a percentage of GDP increased to 0.88 per cent by 0.21 percentage points compared to 1992 (Table 2) and FDI inflows as a percentage of GFCF rose to 4.06 per cent in 1993 by 1 per cent from the previous year (Table 3).

Following the end of the FDI recession in 1993, investment inflows rose by 15 per cent in 1994 (to \$256000 million) and by another 34 per cent in 1995 to reach a record level of \$342391 million. Developed countries were the key force behind the record inflows in 1995. Inflows rose

by 48 per cent in 1995, to \$222484 million in developed countries while in developing countries, inflows of FDI rose by 12 per cent, to \$115801 million. Increase in inflows in 1995 was recorded in equity capital flows and reinvested earnings (Table 1).

Table 2 exhibits that FDI-to-GDP ratio showed an increasing trend since 1991 and rose to 0.95 per cent in 1994 and 1.14 per cent in 1995. However, during the five year period i.e. from 1991 to 1995, average FDI-to-GDP ratio was 0.86 per cent while the highest percentage achieved during the period was 1.14 per cent (in 1995). Table 3 reveals that FDI-to-GFCF ratio also showed the same trend and increased to 4.36 per cent in 1994 and 5.25 per cent in 1995. However, average FDI-to-GFCF ratio was 3.94 per cent while the highest percentage achieved during the period was 5.25 per cent in 1995.

Table 1 reveals that inflows of world FDI increased from 1991 to 1995, to \$342391 million. However, average FDI inflows were \$228332 million during the period, which were more than first three years FDI inflows in absolute terms while the highest growth rate achieved during the period was 35 per cent in 1993. World economic growth and the response of transnational corporations (TNCs) to technological development, international competition and liberalization propelled global FDI inflows to unprecedented levels in 1995.

### **1996-2000**

FDI inflows set a new record in 1996, as transnational corporations (TNCs) responded to economic growth and continued liberalization in most of the world by further expanding their operations abroad. Inflows increased by 13 per cent, to \$388555 million in 1996 (Table 1). The ratio of FDI inflows to GDP and the ratio of FDI inflows to GFCF increased to 1.27 per cent (Table 2) and 5.84 per cent (Table 3) respectively. Table 1 reveals that the upward trend in world FDI inflows set a new record in 1997; inflows grew by 25 per cent, to \$486389 million, the first time that the \$400 billion mark had been reached. World FDI inflows were three times higher what they had been in 1991. Table 2 shows that FDI inflows as a percentage of GDP

increased by 0.33 percentage points and reached to 1.60 per cent in 1997, whereas Table 3 indicates that FDI inflows as a percentage of GFCF increased by 1.53 percentage points and reached to 7.37 per cent in 1997.

In 1998, world inflows reached a record level of \$707584 million, a growth rate of 45 per cent was recorded, the highest growth rate attained since 1991 (Table 1). The dramatic growth of world FDI inflows in 1998 was fuelled to a large extent by a boom in cross-border mergers and acquisitions. Table 2 exhibits that FDI-to-GDP ratio rose by 0.75 percentage points and reached to 2.35 per cent in 1998. FDI-to-GFCF ratio also rose by 3.56 percentage points and reached to 10.93 per cent (Table 3). FDI continue to set new records. In 1999, global inflows reached to \$1089597 million, an increase of 54 per cent over the previous year, which continue to expand rapidly, enlarging the role of international production in the world economy. FDI inflows grew by 29 per cent in 2000, faster than other economic aggregates like world production, capital formation and trade, reached a record level of \$1402680 million. However, the average world FDI inflows from 1996 to 2000 were \$814961 million, which was 3.57 times greater than average FDI inflows of \$228332 million from 1991 to 1995.

The growth of world FDI inflows in 1990s decades has been spectacular. From 1991-2000, the world FDI inflows grew from an annual average of \$521647 million and the highest growth rate of 54 per cent was achieved in 1999 (Table 1). FDI inflows as a percentage of GDP increased by 1.13 percentage points in 1999 and 0.87 percentage points, which had reached to 4.35 per cent in 2000. However, from 1996 to 2000, average FDI inflows to GDP ratio were 2.61 per cent (Table 2). Table 3 indicates that FDI inflows to GFCF ratio were 16.16 per cent in 1999 and 20.09 per cent in 2000. However, average FDI-to-GFCF ratio was 12.08 per cent over the period from 1996 to 2000. Both average FDI-to-GDP ratio and FDI-to-GFCF ratio were higher than the first eight years (1991-1998) since 1991. Inflows of world FDI increased from 1996 to 2000, to \$14026080 million. The upward trend in both, world FDI inflows as a percentage of GDP and world FDI inflows as a percentage of GFCF set a new record in 2000. In the decade of

1990s, both ratios were highest i.e. FDI-to-GDP ratio 4.35 per cent and FDI-to GFCF ratio 20.09 per cent in 2000.

### **2001-2005**

Table 1 reveals that world FDI inflows in 2001 amounted to \$826177 million, a drop of 41 per cent was recorded. This was the first drop in inflows since 1991. The decline in FDI inflows reflects a slowdown in the world economy. More than a dozen economies fell into recession in 2001 (UNCTAD, 2002). To the extent that the events of 11 September 2001 exacerbated this slowdown, they may also have contributed to the further decline in FDI. Therefore, both FDI-to GDP ratio and FDI-to GFCF ratio fell to 2.58 per cent by 1.77 percentage points (Table 2) and 12.17 per cent by 7.92 percentage points respectively (Table 3).

Table 1 shows that there was a sharp decline in the global FDI inflows from 2001 to 2003, which declined by 24 per cent (to \$626874 million) and 9 per cent (\$572790 million) in 2002 and 2003 respectively, following a massive decline of 41 per cent in 2001 (from \$1.4 trillion in 2000 to \$826177 million in 2001). World FDI inflows fell to a low level of \$572790 million in 2003, from a high of \$1402680 million in 2000. Overall world FDI inflows have declined by 41 per cent in 2001, 24 per cent in 2002 and nearly 9 per cent in 2003. The continued decline in inward FDI inflows in 2003 reflected the impact of a combination of macro, micro and institutional factors (UNCTAD, 2003).

At the macro-economic level, growth prospects for many countries remained uncertain. In spite of some recovery in the second half of the year, major stock markets remained well below their historical peak of early 2000. At the micro-economic level, increased profitability starting from the latter half of 2003 helped, but did not increased FDI inflows. High debt-equity ratios continued to force large companies to downsize their operations. At the institutional level, several new accounting scandals in 2003 may have deterred investors. The pattern of FDI

financing (new equity investment, intra-company loans and reinvested earnings) also reflected the macro and micro factors noted above (UNCTAD, 2004).

Both FDI-to GDP ratio (Table 2) and FDI-to GFCF ratio (Table 3) fell to 1.53 per cent and 7.40 per cent in 2003 by 1.05 and 4.77 percentage points respectively since 2001. Table 1 reveals that global FDI inflows rose, for the first time in four years, modestly in 2004 at \$742386 million; nearly by 30 per cent. Global FDI inflows rose by 32 per cent to \$982593 million in 2005 as compared to a 30 per cent increase in 2004, which largely reflected a significant increase in cross-border M&As, both in value and in number of deals. Table 2 shows that the FDI inflows as a percentage of GDP increased to 1.76 per cent in 2004 and 2.15 per cent in 2005, whereas the FDI inflows as a percentage of GFCF (Table 3) increased to 8.30 per cent in 2004 and 9.87 per cent in 2005 after a decline in both ratios in 2003. FDI inflows increased in both developed and developing countries. Developed countries inflows increased by 13 per cent in 2004 and 48 per cent in 2005.

The upward trend in FDI inflows that began in 2004 accelerated further in 2006. FDI inflows increased in the world, developed countries, developing countries and China and India- but at varying rates. The sustained growth of FDI and related international production primarily reflect the strong economic performance and increasing profits of many countries in the world, further liberalization of their policies, and other specific factors such as currency movements, stock exchange and financial market developments and high commodity prices. Increases in cross border mergers and acquisitions (M&As), fuelled substantially by private equity funds, also added to FDI growth (UNCTAD, 2007).

However, during the period of 2001-2005, average FDI inflows to GDP ratio (Table 2) and FDI inflows to GFCF ratio (Table 3) was 1.98 per cent and 9.4 per cent respectively. Both average FDI-to-GDP ratio and FDI-to-GFCF ratio were down than the previous average period of 1996-2000 by 0.63 and 2.68 percentage points respectively. Table 1 reveals that the world FDI



inflows increased to \$982593 million from 2001 to 2005. However, the average world FDI inflows during the period of 2001-2005 were \$750164 million which was nearly 8 per cent lower than average FDI inflows of \$814961 million during the period of 1996-2000.

### **2006-2010**

Global FDI inflows increased by 49 per cent in 2006 for the third consecutive year to reach \$1461863 million, the second highest level ever recorded (Table 1). The FDI inflows as a percentage of GDP increased to 2.95 per cent (Table 2) and FDI inflows as a percentage of GFCF (Table 3) increased to 13.25 per cent in 2006 as compared to previous year. Globally, FDI inflows continued to rise in 2007 at \$1970940 million (Table 1), they reached a new record level, surpassing the previous peak of 2000.

The financial and credit crisis, which began to affect several economies in late 2007, did not have a significant impact on the volume of FDI inflows in 2007, but it has added new uncertainties and risks to the world economy. This may have a dampening effect on global FDI in 2008-2009. All economies- developed, developing, China and India saw continued growth in FDI inflows. The continued rise in FDI inflows in 2007 largely reflected relatively high economic growth and strong economic performance in many parts of the world.

In 2007, the ratio of FDI inflows to GDP (Table 2) decreased to 2.42 per cent, whereas the ratio of FDI inflows to GFCF (Table 3) increased to 15.58 per cent which was the third highest during the period under study. Due to the global economic and financial crisis of 2008, turmoil in the financial markets and the world-wide economic downturn progressively affected global FDI in 2008 and in the first half of 2009. After uninterrupted growth in FDI activity in the period 2003-2007, global FDI inflows fell by 12 per cent in 2008 to \$1744101 million; from a record high of \$1970940 million in 2007 (Table 1). While the 2008 level was the second highest in history, FDI inflows began gradually declining during that year. The ratio of FDI-to-GDP slightly increased to

2.45 per cent (Table 2) whereas the FDI-to GFCF ratio (Table 3) decreased to 12.47 per cent than previous year.

Table 1 reveals that in the first half of 2009, FDI inflows fell at an accelerated rate. In 2009, world FDI inflows declined by 32 per cent than previous year. FDI inflows decreased in 2009 in the world, developed, developing, and China and India economies. This global decline reflects the weak economic performance in many parts of the world, as well as the reduced financial capabilities of TNCs. The position of FDI inflows as a percentage of GDP and FDI inflows as a percentage of GFCF was changed in the year 2009. Both reduced to the level of 1.91 per cent (Table 2) and 9.49 per cent (Table 3) respectively. Global FDI inflows rose modestly in 2010, following the large declines of 2008 and 2009. At \$1.24 trillion in 2010 (Table 1), they were 5 per cent higher than a year before.

Table 2 exhibits that again the FDI inflows as a percentage of GDP reduced to 1.80 per cent. However, during the period of 2006-2010, average FDI inflows to GDP ratio was 2.31 per cent, whereas the average FDI-to GFCF ratio was 12.70 per cent during the period of 2006-2009. It is an average of four years due to unavailability of data for the year 2010. Both average FDI-to-GDP ratio and FDI-to-GFCF ratio was up than the previous average period of 2001-2005 by 0.33 (Table 2) and 3.3 percentage points (Table 3) respectively. Table 1 reveals that inflows of world FDI increased from 2006 to 2010, to \$1243671 million. However, the average world FDI inflows during the period of 2006-2010 were \$1521121 million, which was nearly 103 per cent higher than average FDI inflows of \$750164 million during the period of 2001-2005. The cumulative world FDI inflows were \$16572891 million during the period of 1991-2010.

**Table 1: FDI Inflows by Host Region and Economy (1991-2010)**

(US\$ million)

Year	World	Year	World	Year	World	Year	World
1991	154073	1996	388555 (13)	2001	826177 (- 41)	2006	1461863 (49)
1992	165881	1997	486389	2002	626874 (-	2007	1970940

	(8)		(25)		24)		(35)
1993	223316 (35)	1998	707584 (45)	2003	572790 (- 9)	2008	1744101 (- 12)
1994	256000 (15)	1999	1089597 (54)	2004	742386 (30)	2009	1185030 (- 32)
1995	342391 (34)	2000	1402680 (29)	2005	982593 (32)	2010	1243671 (5)
<b>Average</b>	<b>228332</b>	<b>Average</b>	<b>814961</b>	<b>Average</b>	<b>750164</b>	<b>Average</b>	<b>1521121</b>
<b>Total FDI Inflows (1991-2010) : US\$ 16572891 million</b>							

**Note:** The figures in parentheses shows growth rate calculated on year-on-year basis.

**Source:** www.unctad.org/fdistatistics

**Table 2: FDI Inflows as a percentage of Gross Domestic Product (1991-2010)**

(per cent)

Year	World	Year	World	Year	World	Year	World
1991	0.66	1996	1.27 (0.13)	2001	2.58 (- 1.77)	2006	2.95 (0.80)
1992	0.67 (0.01)	1997	1.60 (0.33)	2002	1.88 (- 0.70)	2007	2.42 (-0.53)
1993	0.88 (0.21)	1998	2.35 (0.75)	2003	1.53 (- 0.35)	2008	2.45 (0.03)
1994	0.95 (0.07)	1999	3.48 (1.13)	2004	1.76 (0.23)	2009	1.91 (-0.54)
1995	1.14 (0.19)	2000	4.35 (0.87)	2005	2.15 (0.39)	2010	1.80 (- 0.011)
<b>Average</b>	<b>0.86</b>	<b>Average</b>	<b>2.61</b>	<b>Average</b>	<b>1.98</b>	<b>Average</b>	<b>2.31</b>

**Note:** The figures in parentheses show percentage point change compared to previous year.

**Source:** www.unctad.org/fdistatistics

**Table 3: FDI Inflows as a percentage of Gross Fixed Capital Formation (1991-2009)**

(per cent)

Year	World	Year	World	Year	World	Year	World
1991	2.99	1996	5.84 (0.59)	2001	12.17 (- 7.92)	2006	13.25 (3.38)
1992	3.06 (0.07)	1997	7.37 (1.53)	2002	9.13 (- 3.04)	2007	15.58 (2.33)
1993	4.06 (1.00)	1998	10.93 (3.56)	2003	7.40 (- 1.73)	2008	12.47 (- 3.11)
1994	4.36	1999	16.16	2004	8.30 (0.90)	2009	9.49 (-2.98)

	(0.30)		(5.23)				
1995	5.25 (0.89)	2000	20.09 (3.93)	2005	9.87 (1.57)	2010	N.A.
<b>Average</b>	<b>3.94</b>	<b>Average</b>	<b>12.08</b>	<b>Average</b>	<b>9.4</b>	<b>Average</b>	<b>12.70</b>

**Note:** The figures in parentheses show percentage point change compared to previous year.

**Source:** www.unctad.org/fdistatistics

## CONCLUSION

An analysis of the trends in FDI inflows at the global level as well as across regions/countries suggests that the liberal policy stance and strong economic fundamentals appear to have driven the steep rise in FDI inflows at global level and different host regions over the period under study. FDI inflows showed an uneven pattern across regions. Improved macro-economic conditions, particularly in the emerging economies, which boosted corporate profits coupled with better stock market valuations and rising business confidence augured well for global FDI prospects. It has been found that FDI inflows have increased at global level as a whole due to globalization which has created hunger for foreign capital in the form of FDI for both developed and developing countries to compete in the international competitive market through investment of FDI in profitable opportunities in their domestic market.

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