

FDI–Growth Nexus in Emerging Economies: Role of Financial Sector Development

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journals.sagepub.com/home/fttr**Pami Dua¹ and Neha Verma²** 

Abstract

This paper examined the relationship between foreign direct investment (FDI) inflows and the growth rate in emerging and developing economies (EMDEs) and whether the development of the financial sector affects the growth-effect of FDI inflows for these economies. FDI enhances capital accumulation in the economy, and the level of financial sector development (FSD) affects the financial intermediation of funds, thereby enhancing the absorptive capability from investment. Using the dynamic panel threshold model (DPTM) for a balanced panel of 71 countries over the period 2000–2019, the paper finds a U-shaped relationship between the measures of FSD and the growth rate of an economy and does not find evidence for the ‘vanishing effect of finance’ for EMDEs. The growth-enhancing effect of FDI is much stronger for countries with a higher level of FSD. Our estimation techniques control for cross-sectional dependence and endogeneity in the case of a dynamic framework. The robustness results estimated using four-year non-overlapping averages as an observational unit support the findings.

JEL Codes: F23, F36, O16

Keywords

Foreign direct investment, financial sector development, economic growth, dynamic panel threshold regression

¹ Department of Economics, Delhi School of Economics, University of Delhi, New Delhi, Delhi, India

² Department of Economics, Kirori Mal College, University of Delhi, New Delhi, Delhi, India

Corresponding author:

Neha Verma, Department of Economics, Kirori Mal College, University of Delhi, New Delhi, Delhi, India.

E-mail: nverma@kmc.du.ac.in