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Interaction of International Capital Flows and Economic Growth in D8 Countries

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EXTENDED ABSTRACT

INTRODUCTION

Financial globalization since the mid-1980s has increased capital flows between industrialized and developing countries. However, foreign direct investment and foreign portfolio investment are the primary and influential factors of globalization. Also, according to theoretical literature, there is a relationship between financial globalization and economic growth of countries dependent on their degree of development, geographical conditions, size of the country in trade, and ..., which may be positive or negative in some cases. On the other hand, sustainable economic growth is one of the preconditions for attracting and exploiting foreign capital. This paper tries to consider the importance of international capital flows (including foreign direct investment and foreign portfolio investment) as the symbol of financial globalization, investigate the interaction between financial globalization and economic growth in a growth model for D8 countries.

METHODOLOGY

In this regard, the specified econometric model is including three equations for economic growth, foreign direct investment, and foreign portfolio investment. Then for estimating the model, the required data are gathered for D8 countries during 1995-2015, and simultaneous equations method in panel data approaches have been used to evaluate the research problem.

FINDINGS

In the specified economic growth equation, the estimated results show a long-run, positive, and statistically significant relationship between economic growth and both types of international investment flows. However, according to the estimated coefficients, the effect of the foreign direct investment on economic growth is more than the foreign portfolio investment in the selected countries during 1995-2015. This result indicates that foreign investment can be a determinant factor for the economic growth in the specified countries. Also, the population growth rate and the fixed capital accumulation positively affect economic growth, while the effect of the real exchange rate and the inflation is negative. In the estimated equation for foreign direct investment, the economic growth, the real exchange rate, and the difference between domestic and foreign interest rates positively affect this variable.

In contrast, the coefficient of other variables, including the portfolio investment, the population growth, and the fixed capital accumulation, is negative, and the results indicate substitution between different types of capital flows. Finally, in the portfolio investment equation, the coefficient of the economic growth rate and the number of internet users is positive, and the coefficient of the foreign direct investment and inflation rate are negative. Hence, economic growth is a determinant factor to absorb foreign investment flows.

CONCLUSION

As a policy recommendation, policymakers should pay special attention to foreign investment flows, especially foreign direct investment. Using suitable and necessary policies, try to promote infra-structures and capacities of their country to absorb foreign direct investment and generate sustainable economic growth.

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