Impact of the Foreign Direct Investment on the Economy of the United Kingdom

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Abstract---This study aims at examining the impact of foreign direct investment in the United Kingdom. The study utilizes the vast empirical literature available on the subject plus data gathered from various reputable organizations. The study first examines the role foreign direct investment plays in economic growth of the United Kingdom and the impacts on the domestic investment. By using regression analysis, the study investigates the relationship between foreign direct investment and economic growth of the United Kingdom. Review of empirical literature sheds light on the particular manner in which foreign direct investment benefits the host country. The study was use different econometric models to establish the relationship between FDI and economic growth. Data for analysis is collected from reputable organizations such as the IMF, Fraser Institution, UNESCO reports, The World Fact Book among others. Secondary data were collected from this study and the data were analysed using the SPSS. Correlation results help in examining the role played by various host country conditions in determining foreign direct investment. Also, the results highlight the significance of the different institutional factors in determining foreign direct investment. This study adds weight to the existing literature on the role foreign direct investment play in the host economies.

Keywords--- Foreign Direct Investment, Economy, United Kingdom, UNESCO reports

I. INTRODUCTION

Foreign direct investment (FDI) acts as a scaffold too many a countries' economies, shielding these economies from experiencing a severe boom-bust cycles that characterize modern capitalist economies. FDI is also the essential ingredient to the growth and development of most economies. According to Carkovic and Levine (2002) [11], Foreign direct investment is the investment done in a country by another (usually companies) that often involves the acquisition or establishment of assets, purchase of stakes, and establishment of operations that can generate income. The investor runs the organization or acquires control of the body. The investor can also be in control of a certain

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production technology, critical inputs used in production or particular organizational skills. Additionally, the foreign investor acquires more than 10% of the voting power in the organization Blomström et al., (2003) [7]. However, this may vary from one country to another. At this stage, it is important to distinguish foreign direct investment from foreign portfolio investment, terms that are often confused. According to Bruno (2016) [9], foreign portfolio investment refers to the investments done by nationals of one country to the securities market of another country. It involves the purchase of shares and bonds in the securities market of another country.

As prior mentioned, FDI is crucial in the growth and development of the economy of any country. In determining the (Gross Domestic Product) GDP of a country, foreign direct investment is considered because it is the significant determiner of the value of the economy. The GDP equation constitutes of gross investments, which is a function of local and foreign investment. FDI is taken as net foreign investment less outward investment or outflow of capital. FDI is made up of three components, namely; short-term capital, long-term capital and equity capital [19]. Various empirical evidence points to the fact that FDI greatly enhances the growth of developing as well as transition economies. The increase in FDI results in a corresponding increase in economic growth. This is brought about by the influx of capital as well as a larger tax collection pool for the host government. According to Aswathappa et al., (2010) [5], FDI contributed over 300 billion pounds in terms of revenue in the year 2000. Thus, FDI is one of the most significant sources of income in developed economies. Much of the FDI is directed into long-term capital projects in the host countries to spur development. Such projects include infrastructure development, energy production, the creation of industries and others.

The first goal of this study is to give the reader a clear picture of the relationship that exists between economic growth, foreign direct investment and domestic investments. Using empirical evidence, the research was analysed the relationship that exists between the three variables. For instance, the study was employ data from different countries to examine whether there is a positive or negative relationship between FDI and domestic investment. To achieve this, the studywasuse a model that comprises of the three factors; domestic investments, foreign direct investment (FDI) and gross domestic product (GDP). The second objective was to examine the role played by the United Kingdom in order to achieve the full benefits of foreign direct investment. A regression model was used to determine results in this section. Additionally, panel-data techniques was employed to establish the impact of foreign direct investment in other countries, mostly the developed countries.

II.   LITERATURE REVIEW

A.   Foreign direct investment (FDI)

Its relationship with economic growth have generated excessive interest among economic researchers over time. As such, there exists a voluminous literature detailing the subject. Some of these studies have identified a positive correlation between FDI and economic development, while a few found no correlation. This section was review different micro-economic studies on the subject to establish the relationship between foreign direct investment and economic growth.

Spickernell(2014) [35] explore the role foreign direct investment plays in the host countries' economies. Their study indicates that FDI is one of the key ingredients for economic growth. Foreign direct investment is identified as the single most important source of capital in the majority of the host countries. FDI contributes to the growth of GDP since it is also a form of investment, similar to domestic private investments. When foreign firms invest in new countries, they usually introduce new or superior technology in the host country. FDI is thus important in allocation of technology to host countries. Additionally to this, spillover effects (economic proceedings in one context that transpire as a result of something else in an apparently distinct framework) also benefit the host economy. FDI is associated with job creation in host countries and also human capital enhancement. Often, the investing firm introduces new managerial skills through partnerships in the host country.

Research by Alfaro et al. (2004) [3] and Hermes and Lensink (2003) [21]analyses the impact of FDI on developed countries' economies. This analysis was conducted subject to a number of critical factors identified in the host countries. These factors include; labour availability, government regulation, market structure and size and the banking system. The study found that countries with better government regulation and efficient financial system have a higher chance of exploiting foreign direct investment and achieving high growth rates. An effective financial system is necessary so as to enable the investing firms obtain things such as credit. The impact of FDI is highest in economies where the local conditions are favourable for investment. To attract FDI, host countries must ensure that their financial system is robust and capable of supporting the foreign as well as domestic investors. Other necessary facilities include support institutions, a stable macroeconomic stability, skilled labor and infrastructure.

B. Economy

Ruxanda(2010) [33] outlined two channels through which FDI may stimulate growth in host economies – this is through transmission of superior technology and knowledge. Transmission of technology occurs mainly through spillovers. When new technology is introduced, domestic firms quickly adapt the new technology, especially where it is not patented. Transfer of knowledge occurs when investing firms introduce new methods of management or new and efficient organizational arrangements. However, conditions in the host country may affect the realization of the full benefits of FDI. According to Chete et al., (2013) [13], the host economies must first achieve a specific milestone in particular development parameters such as education and development of necessary infrastructure before they are able to harness the benefits of FDI. Thus, in less developed countries, foreign direct investment may not have a great impact in terms of accelerating economic growth rate.

An empirical study by Stehrer and Woerz (2009) [36] investigates the impact FDI has on the output of a host country. The empirical study involved an analysis of data from host countries for over 20 years. The study found that foreign direct investment not only increases output, but also the number of exports. This indicates that foreign direct investment enhances growth of host economies. According to the study, for every 10% increase in the level of foreign direct investment there is a rise in the level of output by about 1.2%. The study by Li and Liu (2005) [22] support the findings tabled by Stehrer and Woerz (2009). This study involved an examination of the GDP behaviour using a sample of 84 countries in order to understand the impact of FDI. The study found that FDI promotes

economic growth directly by increasing the stock of capital. Additionally, using the sample of the 84 countries, the duo decided to investigate the impact of FDI on the countries depending on the level of development. They divided the sample size in two; developed and the less developed countries. The results indicated that FDI promotes growth in both developed and less developed countries. According to their analysis, a 10% rise in the level of FDI led to a 4.1% increase in the growth rate of the economy, confirming the study carried out by Vu et al., (2009) [37].

Ruxanda(2010) affirm the results of many studies that foreign direct investment is crucial to economic growth of any country. Foreign direct investment enhances economic growth through transfer of new knowledge, production skills, new technologies, and production of new goods. According to Ruxanda (2010), the full effects of FDI in developed countries' economies are realized depending on the particular countries' ability to implement or improve new/employed technologies. By successfully adapting and implementing new technologies, developed countries was be more to streamline imports and exports. Foreign direct investment induces technology spillover to domestic firms in the host economies. Spillover may occur through copying, learning from the much advanced foreign subsidiaries, competition, linkages and through training. Spillover that occurs through competition is caused by the entry of foreign firms with superior technology. This forces the local firms to adapt new technology in order to remain competitive. In training, firms seek to improve the skills of employees.

Liu (2008) [24] Correlation studies have yet yielded positive results on the relationship between foreign direct investment and the GDP of the countries studied. Borensztein (1998) [8] carried out a correlation study to identify the relationship between FDI and GDP. The study involved a sample of 69 countries in different time intervals. A cross-country regression method was employed in studying FDI and GDP. According to Borensztein (1998), FDI promotes growth of GDP given that some preconditions are fulfilled. First, the host country must have an abundance of human capital. Secondly, he proposed that host countries must produce a pool of skilled labour to ensure skilled production. Other studies show that foreign direct investment is more efficient in improving economic growth compared with domestic investment[25]. This confirms the notion that foreign direct investment leads to technology transfer.

C. *Foreign Direct Investment and Economies*

Foreign direct investment has been considered as an ameliorating force for economic growth since it promotes adoption of the best managerial practices, technical expertise or new technologies [1]. These factors benefit the host country by increasing productivity. Foreign direct investment boosts inward investment in host countries for investors translate this as a sign of confidence in the host economy. In addition, it plays a crucial role in complementing domestic resources in the host countries. Dunning, (2012) [18] assert that foreign direct investment attracts complementary domestic investment that either provides inputs or utilizes the output of the foreign investors. Hassan (2004) observed that private foreign direct investment boosts private domestic investment by increasing credit supply in the host economy. Foreign direct investment partly depends on local financing hence improving the supply of credit in the host economy.

Empirical investigation by Ping et al., (2019)[30]identified a number of channels through which externalities resulting from foreign direct investment can occur in a host country. The first channel involves competition that results when foreign firms enter the local market. The increased competition may lead to higher efficiency in the production process, higher productivity and physical capital investment. This may also lead to more exports as the quality of domestic products is improved. The second channel through which positive externalities flow to host countries is through linkages. Linkage provides opportunities for technology transfers. The third channel is through training. Training involves workers acquiring skills on labour and management. Lastly, positive externalities can occur to host countries through imitation. The domestic firms usually copy or imitate the new technology being used by the foreign investors.

The capital of the United Kingdom, London, is highly ranked worldwide as a commercial hub as well as a cultural center. The UK is second to the USA in terms of foreign direct investment and was the leading in the 2013/2014 financial year in the European region [35]. More than half of the UK new projects are directed to the energy and infrastructure sector. Foreign direct investment is considered as one of the key pillars in achieving growth by the UK government. The UK does not have a specific law regulating foreign direct investment. Hence, foreign investors are guided by the sector laws (for example, oil sector or manufacturing sector) that are followed by other companies. Nonetheless, the government has identified key areas for investing such Information communication technology (ICT), renewable energy, life sciences and creative industries.

III.   RESEARCH METHODOLOGY

The first part of data analysis investigates whether foreign direct investment contributes to economic growth. Both neoclassical and exogenous theories suggest that there are linkages between foreign direct investment and growth of various sectors of the economy. The economy is divided into three major sectors; primary sector that involves extraction, manufacturing sector and the services sector Popa (2014) [31]. It has often been argued that transfer of technology, knowledge, and new production process often impacts heavily on the manufacturing sector. The methodology applied in this study is empirical in nature. This study was analysed data from the different sectors (IMF, Fraser Institution, UNESCO reports, The World Fact Book) of the economy, and establish whether there is any correlation between FDI and the growth of each sector. Scatter diagrams was appropriate in establishing correlation between the various variables.

To establish the impact of foreign direct investment on the overall economy, a special equation was applied. Thus, the overall growth of the economy can be estimated using the following equation.

Growth of the economy = $B_0 + B_1$ Initial $GDP_i + B_2$ Controls$_i + B_3 FDI_i + V_i$.

These variables was taken as exogenous variables.

This data was also be used to analyse the second research question. Thus, it was shed light as to whether foreign direct investment hinders domestic investment in any way.

The third research question investigates whether there a positive correlation between FDI and economic growth. To arrive at the answer on the above issue, a regression model was employed. In employing the regression model, real GDP per capita rates was used. The GDP per capita was regressedin relation to internal as well as external resources. The external sources was equated to the amount of investment the country receives through foreign direct investment. Internal resources are the factors within the host country such as taxes, interest rates, exchange rate stability. Thus internal resources may be development of the financial system, technology gap compared with the investing country, level of infrastructural development, trade openness, and balance of payments position. The independent variables in the analysis are economy growth rate per capita GDP, inflation rate, labour cost per worker in various industries measured logs, risks, and corporate tax rate. The dependent variable is FDI. To get accurate results, regression models require a larger sample size. As the sample size increases, the accuracy of the regression results also increases in a corresponding manner. However, this may be limited due to lack unavailability of the necessary data.

Shahbaz, (2019)[34]In analysing the growth variables, GDP per capita is employed in this study. Openness can be arrived at by looking at the share of exports and imports into the country. This is examinedin relation to the GDP. Government spending can be arrived at by considering at the government expenditure still in relation to the GDP. Human capital was determined by employment rates, university intake rates. Exports, imports was determined by the level of GDP components such as investment, consumption, public expenditure, price competitiveness, national attitude towards foreign goods and shift in domestic patterns of demand and supply such as organization supply of chains and the proprietorship of distribution channels [27].

Cross-section studies was also be helpful in answering most of the questions. Cross-section studies are easy to carry out since the data required can be easily gathered from secondary sources. Secondary sources include economic reports, review of government reports, review of books, magazines and the existing literature in journal articles. These are usually reference materials with information on the topic of interest. Obtain data from secondary sources may be of benefit to the researcher in a number of ways. Firstly, secondary data is cheap to obtain. This is because there is no need for the researcher to gather raw material as it has already been gathered. Use of secondary data in research comes with certain inherent limitations. For instance, it lacks validity and reliability. This is because in some situations, it is not possible to verify the authenticity of the information used by the primary researcher. Also, it is important to note that such data is best suited for the original research it was meant for. In some situations, the primary researcher may modify data in order to fit requirements. Such data may not be reliable to the secondary researcher.

IV.   DATA ANALYSIS

Data from this section was mainly collected from the World Investment Report and United Nations Conference on Trade and Development (UNCTAD). This methodology involves regression analysis. The economic growth rate is indicated by the GDP growth rate. The GDP growth rate is taken as the dependent variable. On the other hand, foreign direct investment (FDI) in the host country is the independent variable. Other important variables considered include total exports as well as gross capital formation. Gross capital formation can be defined as the net value of

investments in the host country within a given period of time. This includes domestic as well as foreign investment. This variable gives us the investment level in the host economy. Net export can be obtained using the following formula: net export = E − I, which is the same as total exports less total imports. This gives the balance of trade position in the host country. The following regression equation was used.

Growth = B_0 + B_1 log GDP + logB_2 Controls + B_3 FDI + V_i, where B_0 is the intercept of the equation, B_1 the parameter for GDP, B_2 the parameter for various control variables, and B_3 the parameter for foreign direct investment. V_i is a term indicating the margin of error. The control variables in this study include human capital, investment rate, net exports, trade, school, and agriculture. Control variables are included as logarithms. The following table (Table 1) gives useful statistical variables for a period spanning 10 years (2000 − 2010), explaining various aspects in the economy of the UK. For instance, it is possible to note that the highest economic growth rate obtained during this period was 6.071, and the minimum growth recorded as -5.051. The least economic growth figure reflects the 2009 financial crunch.

Table 1: Statistical variables

	Growth	GDP	School	Investment Rate	Trade	Private credit	Agriculture	FDI
Mean	1.880	8.534	1.832	2.796	3.516	-1.160	1.125	1.774
Standard deviation	1.673	0.881	1.052	0.412	0.746	0.709	1.373	1.647
Maximum	6.071	9.943	4.567	3.719	5.647	0.312	3.648	10.108
Minimum	-5.051	6.413	0.267	1.807	1.549	-3.319	-3.942	1.042

Table 2 shows the correlation analysis for the data. The table helps in analysing the impacts of foreign direct investment on economic growth of United Kingdom. The regression equation Growth = B_0 + B_1 log GDP + logB_2 Controls + B_3 FDI + $V_i$is applied in this case. The control variables identified include investment rate (I rate), private credit (PC), trade (% of GDP), schooling (average number of students enrolled in school per square mile), and agriculture (% exports in GDP). Schooling gives the level of human capital in United Kingdom.

A. *Correlation analysis*

Table 2: Correlation analysis

Variables	Growth	GDP	Interest rate	School	Trade	Agric	PC	FDI
Growth	1.00							

GDP	-0.02	1.00						
I rate	0.45	0.65	1.00					
School	0.23	0.76	0.62	1.00				
Trade	0.17	0.58	0.47	0.53	1.00			
Agric	-0.09	-0.19	-0.19	-0.12	-0.18	1.00		
PC	0.51	0.54	0.67	0.54	0.51	-0.17	1.00	
FDI	0.25	0.27	0.30	0.18	0.57	-0.09	0.27	1.00

Table 2 confirms that foreign direct investment increases GDP per capita in many aspects. Drawing on results from the table, FDI is positively correlated to most of the economic variables, apart from agriculture. There is a strong correlation from table 2 between FDI and trade, indicating that foreign direct investment may boost trade in host countries.

In order to analyse the impacts of FDI on economic growth, it is necessary to scrutinize the interaction of FDI with various economic variables, vis-a-vis their absorptive capabilities. Thus, the following regression equations was applicable in this case: FDI x Trade, FDI x Agriculture, FDI x I rate, FDI x Schooling, and FDI x private capital. These variables was useful in determining the significance of various factors that affect foreign direct investment absorption in the UK.

B. Regression analysis

Table 3: Regression analysis

Independent Variable	Regression Coefficients	FDI(PC)	FDI(Agri)	FDI(I rate)	FDI(Sch)	FDI(Trade)	Sig. level
GDP	-1.430	-1.294	-1.445	-1.405	-1.432	-1.367	1%
PC	0.541	0.157	0.559	0.553	0.548	0.572	10%
Agri	-0.068	-0.169	-0.145	0.124	-0.067	-0.087	
I rate	2.125	1.832	2.400	2.062	2.178	1.996	1%
Schooling	0.607	0.647	0.532	0.613	0.525	0.628	5%
Trade	-0.264	-0.264	-0.389	-0.456	-0.254	-0.377	

FDI	0.225	0.463	0.312	0.176	0.116	-0.196	1%
FDI x absorptive value		0.335	-0.097	0.034	0.056	0.089	5%
Adjusted R – Square	0.60	0.52	0.58	0.64	0.55	0.56	

N = 40

The results bring to light the need for host countries to achieve a threshold level on investment rates, income levels, and human capital for absorption and spillover effects to occur. The regression coefficient representing foreign direct investment (0.225) as highlighted in Table 3 is positive, with a significance level of 10%. The result suggests that when foreign direct investment increases by a margin of 1%, GDP per capita increases by a margin of 0.225. Likewise, private credit coefficient is positive with a significance level of 10%. The result indicates that when private credit increases by 1%, growth rate increase by 0.5.

With respect to absorptive capabilities of the various variables, the results still show that foreign direct investment is positively correlated to economic growth. The results indicate that FDI is strongly influenced by presence of private capital. The regression term FDI x PC is positive (0.335) with a significance level of 5%. This is almost double the original value when the absorptive capacity is ignored. This shows that the impact of foreign direct investment is greatest in well developed economies. The FDI coefficient remains positive when interacted with human capital. The interaction, however, is not significant. The interaction of FDI coefficient with agriculture produces a negative variable (-0.606) with a significance level of 5%. The negative value indicates that FDI does not have a great impact on agriculture in the economy of the United Kingdom.

To examine the impact of foreign direct investment in the economy of the United Kingdom, the study also chose to conduct an investigation of the impact FDI has on the total employment figures. The following regression equation was applicable in this case:

$TEM_i = a + B_1fdi_{t-1} + B_2gcf_{t-1} + B_3nx_{t-1} + v_t$, where TEM_i is the total employment in the United Kingdom, a_2 the intercept for the equation, B_2 the slope coefficient for FDI, FDI_i the foreign direct investment in UK and z_i the term indicating the margin of error.

By using the SPSS, the following results were obtained for the data above.

Table 4: path coefficients

Model	*Coefficients (Unstandardized)*		*T-Statistic*	*Significance Level*
	B	*Standard error*		

Constant	5.430	0.041	133.50	1%
Log FDI	0.225	0.015	15.50	1%

R Square	*0.670*	*F – statistic*	*241.84*
Adjusted R Square	60.7%	Significance	1%

The adjusted R – Square figure of approximately 67% shows that the regression equation utilizes almost 67% of the data gathered. The value of significance level for the F – statistic is obtained as 1%, hence it is within the 5% significance level. This leads to the rejection of the null hypothesis that states that foreign direct investment does not contribute to economic growth of the host economy. The results indicate that foreign direct investment contributes positively to the economic growth of the economy of the United Kingdom. When foreign direct investment increases by 1% , gross domestic product increased by 10% as indicated.

The following are the SPSS results for the regression equation involving the total employment equation: Growth $(GDP) = a + B_1 fdi_{t-1} + B_2 gcf_{t-1} + B_3 nx_{t-1} + v_t$ where,

FDI = FDI/GDP, gcf = GCF/GDP, nx = NX/GDP and GDP = $(GDP_t - GDP_{t-1})/GDP_{t-1.}$ GDP represents the gross domestic product and FDI the foreign direct investment in the host country. B_1, B_2 and B_3 are all constants. GCF represents the value for the gross capital formation NX the net exports. A time lag of one year is assigned to the independent variables nx, fdi and gcf. The time lag variables enable the researcher to scrutinize important details concerning the previous economic period. In the simplified equation, B_1 represents the slope coefficient for FDI. V_1 is the margin of error, and t the time intervals.

Table 5: path coefficients

Model	*Coefficients (Unstandardized)*	*Standard Error*	*T-Statistic*	*Significance level*
Constant	1.291	0.019	67.42	0.000
logFDi	0.192	0.007	5.748	0.000

R Square	**0.778**	**F-Statistic**	**33.08**
Adjusted R^2	0.678	Significance	1%

The adjusted R^2 results show that the model includes most of the values. The R-Square value is 77.8. Since the model has a significance level of 0.000, the null hypothesis is rejected. Hence, foreign direct investment is positively correlated to increase in the overall employment in the UK economy. The results indicate that a 1% rise in foreign direct investment causes a 19.2% increase in the level of employment.

Both the regression equations fall within the 5% significance level. This indicates that the equations are statistically significant. The results for foreign direct investment and GDP indicate that FDI has a significant impact on the GDP of the United Kingdom. A 1% increase in foreign direct investment leads to a 22.5 % increase in the level of GDP. These are good results in terms of growth. It can also be deduced that increase in FDI leads to the creation of jobs to individuals in the UK. A 1% increase in FDI leads to a 19.2% change in the total employment figures. This figure indicates that the majority of individuals are absorbed by the new foreign companies. This increases the per capita income of the residents. Most foreign investors prefer countries where there is cheap and skilled labour. The UK has a high level of skilled work force.

The effect of the above results as well as other studies has seen governments across the world engaging in massive efforts to attract foreign investment. Foreign direct investment is seen as the catalyst for economic growth through technology spillovers and a host of other benefits. According to Ajayi (2006) [2], FDI creates both tangible and intangible benefits to the host country. Tangible benefits are realized in the form of technological advances (new equipments) and capital accumulation (physical capital and human capital). On the other hand, intangible benefits to the host country include new knowledge and skills, management skills and technological augmentation. Such benefits not only circulate within the foreign investors, but also spillover to domestic firms in and thus amplifying growth and productivity in all sectors of the economy. Colen et al., (2008) [14] postulated that spillovers lead to welfare economics to the host countries.

The benefits accruing to host countries from multinational corporations and foreign direct investment are transferred in a number of ways. The transfer of these benefits usually occurs through direct contact of the multinational corporation with the domestic firms Gorg and Greenaway (2003) [20]. The most common ways include training of local workers to enhance their skills, direct transactions with domestic firms that may be supplying certain products to the MNC, domestic firms using the output of new foreign firms or simply through stiff competition that forces the domestic firms to adopt new technologies or methods of production (OECD, 2003).

A number of studies have also highlighted competition as a means through which technology transfer occurs. Entry of foreign firms into the host economy may intensify competition in the host economy, especially if all the firms are dealing in a similar product Pack and Saggi (1997) [29]. In order to survive the intense competition, domestic firms are forced to adapt the latest technology. Those that are unable to improve the quality of their product may lose their market share. Technology transfer also occurs through imitation or copying the multinational firms. Exposure of local firms to superior technology often drives them to follow suit in order to maintain their relevance in the market. Copying may also involve acquiring new managerial practices from the multinational

753

corporations. Technology transfer has led to the production of better products that are easily marketable, even in the international market. This has significantly contributed to the economic growth of the United Kingdom's economy.

According to De Mello and Luiz (1997) [15], foreign direct investment has led to the growth of economy of host countries through increasing the level of skill among workers. Human capital is one of the most imperative resources required in production. Without skilled capital, production of processed goods is critically affected. Countries that lack enough skilled manpower usually export their products as raw materials and later import at a higher price as finished goods (Herzer and Klasen, 2008). Multinational corporations usually employ local workers who gain by learning new skills either technological or managerial skills. The workers transfer these skills when they leave the corporation to work for other domestic firms or when they start their own firms. The movement of workers from multinational corporations to domestic firms, thus helps in technology and skill transfer process.

It has been argued that multinational corporations increase access to the international market [16]. Multinational corporations have superior marketing skills and in most cases control a sizeable share of the international market. Thus, their distribution channels are widespread in most parts of the world. Multinational corporations provide this knowledge to domestic firms, thus helping them expand their market.

C. *Investigating the factors that enhance absorption of positive externalities in the UK*

This section investigates the role played by host country conditions in attracting foreign direct investment. These conditions include political risks, corruption, rule of law, contract enforcement laws among other institutional conditions. The majority of studies conducted have concluded that institutional conditions in the host country have a significant impact on attracting foreign direct investment. Nonetheless, some studies have found no correlation between institutional conditions and the level of foreign direct investment. Osinubiand Amaghionyeodiwel (2010) [28] conducted a study to investigate the impact of host country institutional conditions such as political risk and democracy on attracting FDI. The study results indicated that there was no significant correlation between foreign direct investment levels and the aforementioned institutional conditions. The results of such a study may have been based on a small sample thus giving a negative result.

D. *Regression equation*

A simple regression equation was employed in this study. The following equation was applied in this study:

$$\log FDI = a_i + BInst_{it} + EV_{it}\S + V_{it}$$

The dependent variable is taken to be the FDI. FDI is obtained as the log off di/GDP, in order to take into consideration the country size. 'Inst' represents the institutional quality in the host country. This data was obtained from International Country Risk Guide (ICRG), which provides data on political, financial, and economic risks for various countries around the world. ICRG provides individuals and multinationals with ratings based on data assessed using over 30 metrics. ICRG conducts an analysis of over 140 markets, and is world renowned in its financial data reporting. For this study, the variables used are drawn from ICRG based on law & order index as well

as the investment indicators index. 'Inst' takes the values from 0 – 12 whereby lower values are an indication of weak host country institutional conditions and vice versa. EV represents control variables; a_i is a constant and $v_{it}$the error term; i represent the sample size and t the number of periods.

The control variables were chosen depending on the most influential to the GDP. The variables chosen have appeared in majority of the past studies. For instance, trade openness has appeared in the majority of past studies. Trade openness is considered as having a heavy impact on foreign direct investment. According to Chakrabarti (2001) [12], trade openness and market size are the most influential to the level of foreign direct investment in any country. Thus, trade openness and market size are closely linked to the level of foreign direct investment. Other important control metrics include quality of infrastructure, trade tariffs, and inflation rates. Quality of infrastructurecan be estimated by the number of people who have telephone lines per given area or persons. The following were the control variables chosen for the purpose of this research.

LogGDP$_{pc}$: This is the GDP per capita, taken as the log. This gives us the GDP in relation to the market size of the country. Host countries that have a larger market size are more attractive to foreign investors.

Open: This indicates the host country's openness to trade. Countries that have favourable laws to investors attract foreign direct investment compared to those whose laws are not constructive to investors.

Tariff: This indicates the impact trade regulations have in the host country FDI. Favourable trade policies increase foreign direct investment in any country.

Inflation: Inflation rate can be measured using the consumer price index. Inflation rates indicate the general increase in prices in the economy. It shows the macroeconomic stability of a particular economy.

Tel: This is a measure of infrastructure development in the host country. This is estimated by establishing the number of telephone lines per a thousand individuals. Foreign direct investment is positively correlated to infrastructural development. Foreign investors usually prefer countries with a good network of infrastructure ranging from roads, electricity, and other necessary infrastructure.

logTax: This is the log of corporate tax levied by the government. Statutory taxes can affect foreign direct investment either positively or negatively. Statutory taxes have an effect of raising the prices of goods and services produced in an economy.

Inst: This is an indicator of the institutional variables.

The following regression equation was as expressed below:

$$FDI_{it} = a_i + BInst_{it} + \S_1 GDPG + \S_2 LogGDPpc + \S_3 Open_{it} + \S_4 Infl + \S_5 Tel_{it} + \S_6 Tariff + \S_7 LogTax + v_{it}$$

This data covers the time period from 1986 to 2010, on a 5-year interval. The data was averaged on a 5 year basis to ensure that there were no negative or zero values that would affect the regression. It is important to note that

zero and negative values are not included in regression, thus it would be best to avoid them in the making of the observations.

The following table shows the results obtained

Table 6: regression equation

Variable	FDI	LogGDP$_{pc}$	Tar	Inst	Infla	Tel	Openness	Log Tax
Mean	0.28	7.26	19.56	5.66	57.82	100.76	61.66	3.63
Standard Deviation	1.43	1.13	15.87	1.84	257.87	118.20	37.67	0.56
Minimum	-6.75	4.30	0.00	2.13	-1.65	0.18	8.43	2.98
Maximum	2.01	3.06	95.20	11.4	2764.87	567.55	312.7	5.09

N = 38

Data obtained was obtained from: The World Bank, 2015, OECD, 2013, ICRG, 2015 and UNCTAD, 2014.

The following table shows the correlation results for the various control variables and foreign direct investment.

Table 7: correlation results for the various control variables and foreign direct investment.

Variables	FDI
FDI	1.00
LogGDP$_{pc}$	0.163
Tel	0.232
Tariff	-0.435
Openness	0.42
Inflation	-0.14
GDP Growth	0.2
Log Tax	-0.34
Inst	0.33

Table 7 sheds light on the relationship between various variables and foreign direct investment. There is a negative correlation between FDI, tariffs, inflation, and tax. This means that when any of these variables is increased, foreign direct investment is negatively affected. On the other hand, FDI has a positive correlation with variables such as infrastructure, GDP per capita, openness to trade and institutional quality. Highest correlation is recorded between FDI and openness to trade. This means that host countries should review their trade policies in order to attract foreign investment. Trade policies must be favourable to foreign investors who stand in a losing position compared to domestic producers. The study results echo Morgan and Katsikeas's assertion (1997) [26] that domestic firms hold an advantageous position over the foreign firms in terms of culture, consumer preference, language, local regulations, among other factors. To put the foreign firms on the same threshold as domestic firms, the host country must develop complimentary laws that are attractive to the investors.

The results also indicate that foreign investors are attracted to markets that record growth. This can be deduced from the positive correlation between FDI and GDP growth (GDPG). The strong correlation indicates that foreign investors take keen interest in the size of the market before making an investment decision. The correlation results for tariff indicate that it is important for host countries to allow liberal trade. Tariffs may curtail foreign direct investment as indicated by the strong negative correlation (-0.4). Development of infrastructure is also relevant as indicated by the strong correlation between telephone lines and FDI. Foreign investors are comfortable taking their investments in countries where the necessary basic infrastructure is available. Infrastructure is necessary in facilitating production and transport of the finished products to the market. Statutory tax is critical in determining the level of FDI as shown in the results. Host countries should lower statutory tax in order to attract foreign investors. Their results indicate a positive correlation between institutions and foreign direct investment.

E.   Regression results

Table 8: Regression results

FDI	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Sig level
Log GDP	0.259	0.303	0.215	0.263	0.231	0.365	
Tel	0.925	0.640	0.847	0.923	0.834	0.676	5%
Tariff	-0.072	-0.003	-0.041	-0.046	-0.067	-0.015	5%
Openness	0.0178	0.021	0.018	0.016	0.017	0.017	10%
Inflation	-0.053	-0.032	-0.044	-0.048	-0.052	-0.043	10%
GDP Growth	0.280	0.183	0.248	0.256	0.240	0.237	10%
Log Tax	-0.081	-0.097	-0.081	-0.085	-0.101	-0.093	5%
Adjusted R^2	0.48	0.51	0.48	0.44	0.49	0.47	
F statistic	6.09	5.71	5.84	5.12	5.38	5.46	

Regression results from Table 8 give more insights on those factors that determine absorption of FDI in host countries. The results indicate that openness to trade, development of infrastructure, size of the market and tax levels have a significant impact on the level of foreign direct investment in the UK. The result for FDI and infrastructure is positive, with a significance level of 5%. This indicates that infrastructural development plays a crucial role in

attracting inward FDI. The result for tariff is negative with low significance level of 5%. This indicates that tariffs may negatively influence foreign direct investment. The result for inflation is negative with a significance level of 10%. This indicates that inflation is a crucial determinant of the level of foreign direct investment in the United Kingdom. Investors are also attracted to countries that record high GDP growth. The result for GDP growth is positive with a significance level of 10%.

Thus, the key to attracting foreign direct investment is by maintaining an open trade policy and ensuring presence of adequate support institutions in the host country. Other important determinants include the statutory tax levels, quality of the infrastructure and the market size. Macroeconomic variables such as inflation do not play a significant role in attracting foreign direct investment. Policy makers must thus develop proper guidelines in order to attract foreign direct investment. The United Kingdom government has maintained an open policy that attracts foreign investors. In addition, the region has adequate infrastructure that is key in determining the level of foreign direct investment.

Some studies analyse the role played by various institutional aspects such as property rights, democracy, social tension, political instability, and corruption among others in order to ascertain the most important in determining FDI. According to Liu et al., (2000) [23], protection of property rights is highly significant in determining foreign direct investment. Thus host countries must develop institutions that recognize and enforce property right rules. This is because most of the multinational corporations are involved in research and development; hence the importance or the need for protection of property rights. The study also found that there is a high correlation between property rights and political instability or democracy. According to Asiedu (2002) [4], the significance of the various institutional aspects depends on the sector of the economy, for instance, whether it is the manufacturing sector, primary sector, or the services sector. Foreign direct investment may thus be high irrespective of the political stability prevailing in the host country. An example of such a scenario is an investment in the petroleum industry. As Busse (2004) [10] asserts, when the expected returns are high political risk and other institutional risks become less relevant.

The last part of this study wasanalyse the role of the government in relation to attracting foreign direct investment. Investment is the key driver to economic stability. The government's actions have a direct impact on the level of foreign direct investment. The United Kingdom government has in the past made decisions that significantly affected foreign direct investment in the region. One of the key decisions that improved FDI inflows is the integration into EU region. The Single Market European integration removed many of the trade restrictions, enabling investors to set up firms in the UK with ease. Nonetheless, studies indicate that for maximum benefits to be realized in the host country, governments must develop a proper regulatory framework that guides investment by foreign firms. The major goal ought to be attracting foreign direct investment that resonates well with the country's vision; investment that has the least negative impact in terms of crowding out effects, environmental issues, labour issues, and transfer pricing.

Host government regulation should mainly stem from the following reasons:

- Protection of domestic firms that may not be able to compete with the multinational corporations due to crowding out effects.

- The need to achieve maximum benefits to the local community in terms of job creation and safety of the environment.

- Ensuring there is proper linkage between MNCs and domestic firms to facilitate transfer of technology and managerial skills.

- Developed countries in particular need to improve effective policies to ensure they receive maximum benefits from foreign direct investment.

Unlike countries such the United Kingdom that have a balance between inward and outward FDI flow, most of the developed countries basically import FDI with little or no FDI outflows. To majority of them, the major concern is how to improve FDI inflows. Developed countries should improve their policies to ensure that foreign direct investment benefits the economy. For instance, not all the profits should be repatriated to the foreign investor's country.

Dunning and Narula (2003) [17] Host governments should not overlook the important role played by incentives in attracting foreign direct investment. Incentives are usually offered by developed countries in a bid to attract FDI inflows. Two types of incentives are commonly offered in developed nations [32]: Tax relief and financial incentives. Tax relief involves reducing the income-tax rate that foreign investors are supposed to submit to the relevant authorities. Tax relief may also be offered in terms of tax holidays, import duty exemptions, and lowering the duty on exports. Financial incentives usually include subsidies, grants, loan guarantees, and providing insurance at favourable rates among others [32]. Studies have shown that these incentives significantly help in attracting foreign direct investment. Incentives complement the local host conditions in attracting foreign direct investment into the host country.

Foreign direct investment should be directed to specific sectors of the economy. Hence, host governments should attract foreign investors selectively since in some situations, foreign direct investment may turn out of little benefit to the economy. Foreign direct may improve the GDP of the host country, but on the other hand fail to improve the welfare of the citizens. For example, most developed countries in Europe for example Germany depend on service sector (Manufacturing, fishing, and extraction for instance mining) as the backbone of their economy. Foreign direct investment should thus be more concerned on other areas where the local individuals and firms have minimum exploited such as agriculture and tourism. This may encourage diversity and development of more industries. Foreign direct investment is not the panacea for economic growth; rather governments must ensure that FDI provides maximum benefits to the economy [6].

F. Results and discussion

Correlation results in Table 2 indicate that there is a positive correlation between FDI and most of the economic variables such as trade, investment rate, private credit and schooling. However, the results indicate negative

correlation between FDI and agriculture. Regression analysis in Table 3 indicates that foreign direct investment and economic growth (increase in GDP) have a positive correlation. The positive impact on economic growth of the United Kingdom is realized both directly through employment creation and indirectly through spillover effects. The results indicate that foreign direct investment is one of the key determinants of economic growth in both developed and the less developed countries.

The second part of the study indicates that foreign direct investment has a positive effect on GDP levels as well as the total employment figures in the UK. The results from Table 4 and Table 5 indicate that foreign direct investment has a positive and significant impact on the GDP and total employment figures in the United Kingdom. A 1 percent increase in foreign direct investment leads to a 22.5 percent increase in the level of GDP. In addition, the results indicate that a 1 percent increase in FDI leads to a 19.2 percent change in the total GDP figures. Thus, foreign direct investment directly contributes to direct employment in the United Kingdom, and in the process raising the GDP of the country. The figures indicate that the majority of individuals are absorbed by the new foreign companies. This increases the per capita income of the residents.

The third section analyses the impact of host country conditions on foreign direct investment. The results indicate that institutional factors are crucial in determining FDI. However, the impact of host country conditions depends on the FDI sector. Generally, openness to trade, market size and the level of corporate tax rank high among the factors that determine foreign direct investment. The primary sector (extraction) is least affected by the host country conditions. It is worth noting that macroeconomic variables such as inflation have little impact on the level of FDI. This section is important since it identifies the conditions that host country governments ought to give priority in attracting foreign direct investment.

The last section indicates that there is need for host country governments to develop a proper policy framework regarding foreign direct investment. Host countries should protect domestic investors from negative impact that may result from the entrance of multinational corporations. The new firms may increase competition forcing the domestic firms to lose their market share. The government should provide regulation in terms of subsidiaries, tax exemptions, and developing proper investment policies. Apart from this, the host government has the responsibility to ensure that maximum benefits are enjoyed by the citizens from the foreign investors. Environmental protection is also a key concern for host governments. The government must ensure that operations of foreign investors are not detrimental to the environment. Foreign investors should be encouraged to invest in those sectors of the economy that domestic investors have been unable to exploit. This wasensure that maximum benefits are realized from foreign direct investment.

V.   CONCLUSION

The purpose of this study was to determine the impact of foreign direct investment in the economy of the United Kingdom. Numerous foreign direct investment literatures are available, especially in light of developing countries. This study investigates the role foreign direct investment play to the economy of a developed region, a break from the monotony in investigating FDI and economic growth in underdeveloped countries. In order to comprehensively

study the impacts of FDI in UK, four investigation parameters were identified. First, the study examines the correlation between FDI and economic growth, and the type of correlation that exists. This is determined by employing a regression analysis. Secondly, the study seeks to array suggestions that foreign direct investment crowd's domestic investment. In this section, analysis of available literature on the topic is used to develop a conclusion based on past researches as well as available data. Thirdly, the study seeks to examine the role played by host country conditions in determining foreign direct investment. This section analyses the impact of various conditions such as institutional factors on foreign direct investment in the UK. Regression and correlation analysis is employed to explain the relationship among the various factors and FDI. Lastly, study of available literature sheds more light on the role host country governments should play in attracting and regulating FDI.

A. Recommendations

The results from Table 1 – 4 indicate that foreign direct investment is significant to the growth of the economy of the United Kingdom. This contribution of FDI to economic growth is in fact higher than earlier thought. The results justify the need for the government to offer the necessary incentives or support to foreign investors. It is important for governments to recognize the positive role FDI plays in the UK's economy, more so in creation of employment and enhancing spillover effects. In addition, the government should gear up efforts on improving institutional quality so as to enhance the absorption of positive externalities from FDI. This would ensure that instead of a country grappling with negative effects of FDI on its economy, positive externalities are realized in full.

The results from Table 7 & 8 reveal the need for development of proper policies by host countries in order to attract foreign direct investment. Host governments must encourage foreign investment by ensuring the local conditions are favourable for investment. In encouraging foreign direct investment, host countries should not neglect domestic investors as this may lead to job cuts, especially in the private sector. Over the recent years, other European countries have emerged as investment destinations for most MNCs. This has mainly been occasioned by reduced tax rates, policies that encourage exports and few growth barriers [28]. Despite the UK being an open economy, the government should increase incentives in order to woo investors. For instance, there is a need for the introduction of a new competitive tax system that can attract foreign investment into the region. Secondly, the UK government should develop policies to encourage export of produce to key markets around the world. Foreign investors prefer host countries that offer such supportive services.

B. 5.2 Future Research

Future research should be focused on finding a causal relationship between FDI and economic growth in United Kingdom. It is recommended that future research include other macroeconomic indicators (such as unemployment rate, gross national product, purchasing power parity, poverty level, and foreign exchange rate), which may help to better explain the effect of foreign investment on the economic growth of United Kingdom.

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