

## Testing for Endogeneity of Foreign Direct Investment: Implications for Economic Policy

**Authors :** Liwiusz Wojciechowski

**Abstract :** Research background: The current knowledge does not give a clear answer to the question of the impact of FDI on productivity. Results of the empirical studies are still inconclusive, no matter how extensive and diverse in terms of research approaches or groups of countries analyzed they are. It should also take into account the possibility that FDI and productivity are linked and that there is a bidirectional relationship between them. This issue is particularly important because on one hand FDI can contribute to changes in productivity in the host country, but on the other hand its level and dynamics may imply that FDI should be undertaken in a given country. As already mentioned, a two-way relationship between the presence of foreign capital and productivity in the host country should be assumed, taking into consideration the endogenous nature of FDI. Purpose of the article: The overall objective of this study is to determine the causality between foreign direct investment and total factor productivity in host country in terms of different relative absorptive capacity across countries. In the classic sense causality among variables is not always obvious and requires for testing, which would facilitate proper specification of FDI models. The aim of this article is to study endogeneity of selected macroeconomic variables commonly being used in FDI models in case of Visegrad countries: main recipients of FDI in CEE. The findings may be helpful in determining the structure of the actual relationship between variables, in appropriate models estimation and in forecasting as well as economic policymaking. Methodology/methods: Panel and time-series data techniques including GMM estimator, VEC models and causality tests were utilized in this study. Findings & Value added: The obtained results allow to confirm the hypothesis states the bi-directional causality between FDI and total factor productivity. Although results differ from among countries and data level of aggregation implications may be useful for policymakers in case of providing foreign capital attracting policy.

**Keywords :** endogeneity, foreign direct investment, multi-equation models, total factor productivity

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