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The Role of Foreign Direct Investment in Shaping income Inequality in Developing Economies: A cross-country Analysis

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Abstract: *Income inequality represents a significant and enduring challenge facing many developing economies around the world. In this context, Foreign Direct Investment (FDI) has emerged as a key factor deserving careful examination. The globalization of markets and the increased mobility of capital have led to a surge in FDI inflows into developing countries. FDI flows into developing countries have surged in recent years, raising questions about their impact on income distribution. This study conducts a cross-country analysis to unravel the intricate relationship between FDI and income inequality. This research aimed to investigate the relationship between Foreign Direct Investment (FDI) and income inequality in a diverse set of developing economies while exploring regional variations in this relationship. The study findings indicate a significant positive correlation between FDI and income inequality, underscoring the need for policymakers to consider the distributional consequences of FDI. Additionally, the analysis reveals that the impact of FDI on income inequality varies across different regions within developing economies, emphasizing the importance of tailored policy approaches. This research contributes to a deeper understanding of the complex FDI-income inequality nexus and calls for future studies to delve into the underlying mechanisms and propose evidence-based policy interventions. Ultimately, this work encourages scholars and policymakers to address the pressing global challenge of income inequality and leverage FDI as a tool for more equitable economic development in developing economies.*

Keywords: - *Foreign Direct Investment (FDI); Income Inequality; Globalization; Developing Economies; Cross-country Analysis.*

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1. Introduction

For nations with highly developed absorptive capacities, FDI reduces income disparity more than for those with less developed absorptive capacities. In recent years, one of the most hotly contested topics among economists and decision-makers in both rich and developing nations has been the impact of foreign direct investment (FDI). The huge increase in FDI going to least developed nations has greatly strengthened the debate. According to estimates, FDI inflows to least developed nations were $35 billion in 2015, up 133% from 2005 (UNCTAD, 2016).A substantial amount of theoretical and empirical work has been devoted to examining the varied consequences of FDI on host economies, in keeping with the trend of rising economic globalization that has been occurring over the past three decades. However, as several authors have noted, the majority of research has typically concentrated mostly on the efficiency results of FDI, such as economic growth and productivity, while generally ignoring their distributional implications. There is a need for more research on this subject because studies on the effect of FDI on income disparity are still in their infancy, rare, and confusing. Additionally, public concerns about the socioeconomic effects of excessive income disparity are growing, especially in the wake of the recent global economic crisis, and this problem is now a major topic of discussion in both political and academic circles (Mihaylova, 2015).

Most study focused on the effects of efficiency or, more precisely, productivity and economic growth at either the macro or micro level when examining the impact of growing foreign direct investment (FDI) on host countries (Borensztein, et al., 1998). While it is typically discovered that FDI can have positive growth and, hence, an efficiency effect, the issue of equity is typically overlooked. This makes an effort to address the issue by offering a thorough examination of how FDI affects inequality in the receiving country. In this essay, inequality is defined as pay disparity. In other words, we want to find out if FDI is neutral with regard to inequality because it benefits everyone equally in terms of salaries, or if it actually makes wage inequality worse (Figini, & Go, 2011).

While there is some agreement on the positive relationship between openness and growth, the effects of increased trade and foreign investment on national economies are a matter of significant disagreement (Rodrik, 2001). There is little consensus within communities as to who gains. On the basis of encouraging exports and luring Foreign Direct Investment (FDI), the East Asian region appears to have accomplished equitable growth with poverty reduction. The widely held belief that East Asian export-focused industrialization fostered distributional equity. According to this viewpoint, trade enables the growth of industries that heavily rely on the abundant production component. Low-skilled labor was in high supply in many East Asian nations in the 1970s and 1980s, thus trade should have increased demand for this type of labor. Wood claimed that it is likely that this has occurred. The impacts on pay inequality can be viewed as being less evident, in part because few studies account for domestic (supply) factors even though "relative supply shifts could explain relative wage outcomes in the open Asian economies and the Philippines" (Robbins, 1996). In addition, contrary to expectations based on conventional trade theory, trade liberalization in seven East Asian and Latin American nations was accompanied by an increase in relative wages and skill demand (Te Velde, & Morrissey, 2004).

The impact of globalization on income inequality is one of the current issues in the field of international development. The claim is that income disparity issues in developing nations are a result of globalization. The purpose of this article is to empirically investigate whether income inequality issues in transitional nations are made worse by globalization, particularly Foreign Direct Investment (FDI), a significant aspect of globalization. Even though FDI is seen as a driver of economic expansion, it can also have negative consequences on a nation, such as widening the wage gap between skilled and unskilled workers or escalating regional inequality. In this instance, a good way to gauge all forms of inequality is income inequality. The idea of income not only encompasses both salary and rental income, but it also serves as a valuable tool for comparing regional disparities. To investigate the connection between FDI and income inequality, a special dataset of nations is used. Eastern European transitional nations and states from the former Soviet Union are included in the collection. This study covers the period from 1990 to 2002 and covers 19 transitional nations. Immediately after, wage and income disparity increased, while the latter eventually stabilized at a higher level. Additionally, over the past ten years, these countries have received more FDI from abroad (Bhandari, 2007).

A significant portion of the enormous private investment that has been fueling economic expansion worldwide, especially during the last two decades, is foreign direct investment (FDI). The majority, if not all, developing nations are looking for FDI as a way to supplement their domestic investment levels and secure gains in economic efficiency across the board through the transfer of suitable technology, management know-how, and business culture, access to foreign markets, increased employment opportunities, and higher living standards. In order to achieve this goal and guarantee that FDI is consistent with domestic economic development goals, policymakers have taken into account a variety of incentives and policies to encourage FDI. Evidence suggests that in the worldwide fight for this floating capital, those that provide secure and lucrative investment possibilities prevail. Indeed, industrialized countries receive the majority of the FDI in the globe nowadays. However, investment is also rising in developing nations. Since the mid-1970s, several developing nations have been effectively developing by opening their economies to FDI in accordance with outward-focused development plans, particularly the rapidly industrializing Asian nations and more recently some Latin American nations (Dabour, 2000).

There has been much discussion on the contribution that foreign direct investment (FDI) makes to economic growth. Many academics and policymakers have claimed that FDI can benefit the host country's development efforts, and as a result, developing countries should embrace FDI as a way to foster economic progress. The basic claim in favor of FDI is that in addition to providing direct capital finance, it may also serve as a conduit for the transfer of valuable technology and know-how while establishing connections between foreign competitors and the partners in the host economy. This line of reasoning contends that FDI is a means of transferring innovative concepts, cutting-edge methods, technology, and skills across national boundaries while having significant spillover benefits. The growing desire of developing nations to use exports as a platform for FDI has recently come up as a significant problem addressing the relationship between FDI and growth. The export platform FDI, also referred to as "EPFDI," is based on the notion that multinational corporations (MNCs) and their foreign affiliates prefer to invest in export-oriented industries in the host countries, and as a result, the local market in the host country has no bearing on the MNC's location decision (Aurangzeb, & Stengos, 2014).

The impact of foreign direct investment (FDI) on socioeconomic factors has been extensively studied in recent decades. Studies focus on how FDI affects macroeconomic growth, productivity, and efficiency at both the micro and macro levels. The majority of studies have determined that FDI has a favorable influence on the economy of the host country, particularly in developing nations, but their conclusions about its effects on social justice, including income inequality, are less certain. For a variety of reasons, the effect of FDI on income inequality is of concern. The first is that income inequality hinders economic expansion. Second, the progression of poverty reduction may be hampered by the rise in income inequality. Finally, those who are interested in relative income frequently want to live in a society where everyone is treated equally. Therefore, FDI's beneficial benefits on economic growth will be replaced by a lower rate of growth as well as other socioeconomic negative effects if it raises wealth disparity. For developing nations, which rely largely on FDI, this is a major worry. Social stability is crucial for economic growth in these nations (Le, et al., 2021).

Foreign direct investment (FDI), which also acts as a substantial development driver, is necessary for a free and effective international economic system. However, the benefits of FDI are not automatically and fairly dispersed among nations, industries, and local communities. National policies and the global investment architecture are crucial if poor nations are to fully benefit from FDI for development. The challenges largely affect the host countries, which must establish an open, inclusive, and supportive policy environment for investment and build the institutional and human resources required to put it into action. In emerging countries, foreign direct investment (FDI) has long been a major policy concern. The contribution of FDI to a nation's external financing and economic growth, the conduct of multinational corporations, and the level of regulation of FDI and other types of capital flows are some of the issues on which policymakers often have to take a stand. It is no accident that economic research has devoted a lot of time and effort to studying these issues. The worries regarding FDI in developing countries, particularly the two topics that have recently been the focus of study and discussion. The first is whether and how FDI affects economic expansion. The second is the impact of utilizing natural resources, which are typically created by foreign investors, on economic growth. The solutions to these two interconnected problems will affect how FDI is managed in developing countries. Foreign direct investment helps the economy flourish. There is no compelling reason to favor one industry over another, hence incentives for FDI should generally not be provided on a discriminatory sectoral basis without such rationale. There are no convincing arguments to support the claim that manufacturing rather than the development of natural resources may be detrimental to growth, even though the subject of industrial strategy is outside the purview of this essay. But as this essay has shown, an educated labor force is required to promote technical dispersion, the adoption of superior technologies, and to fully realize the benefits of FDI (De Gregorio, 2005).

Many researchers and decision-makers hold the belief that foreign direct investment (FDI) is unique in some way. One widely held belief is that FDI hastens the path of economic development in host nations. Wide-ranging changes in national FDI policy have been made as a result of optimism about the economic effects of FDI and increased knowledge of the value of new technology for economic growth. Many emerging economies have significantly lowered their FDI barriers over the past 20 years, and nations of all development levels have built architecture of policies to entice multinational corporations. Extension of tax vacations, exemptions from import tariffs, and the provision of direct subsidies are common strategies to encourage FDI. By favoring one type of market integration over others, such as increased trade in goods, more international technology licensing, or larger cross-border flows of portfolio capital, promoting FDI goes one step further than simply eliminating barriers to foreign investment. The challenge of evaluating how FDI promotion would affect national welfare is significant, and we do not in any way aspire to fulfill it entirely. We examine whether the benefits of FDI are sufficient to support the kinds of policy interventions that are currently being implemented, according to academic research that has been conducted. This will make it easier to determine a set of useful guidelines for when and how encouraging FDI might improve well being (Hanson, 2001).

The premise that foreign direct investment (FDI) is merely one of numerous shapes that international capital flows might take, generating output in lower cost regions or moving production there, forms the foundation of much of the analysis and research on FDI. This viewpoint has the benefit of having a theory of global capital flows that takes into account regional variations in capital abundance and return. This kind of thinking, when applied to direct investment, underpins the worry or expectation that foreign direct investment will probably replace exports. Studies on numerous FDI-related topics have revealed traits throughout time that indicate this perspective overlooked many crucial features of direct investment. For instance, the majority of direct investment occurs between industrialized nations, where there aren't many significant variations in the rates of return and capital abundance. Additionally, it is often discovered that domestic production and exports are favorably correlated with one another, both geographically and through time, for businesses and nations (Lipsey, 2001).

2. Literature Review

Gam, T. T. H. et al., (2023) discussed the income inequality in particular and discussed inequality in general was long existed and is likely to continue to grow. It was anticipated that foreign direct investment (FDI) were play a significant role in helping to mitigate that scenario. Previous empirical research was the effect of FDI on income disparity did not, however, come to a consistent conclusion. In order to determine how foreign direct investment affects income disparity was industrialized economies, a study was conducted. Data from a sample of 36 developing nations were submitted to the study as proof that the link was nonlinear. In addition, other factors like as migration and trade openness, also affect income inequality. When FDI interacted with commerce or migration, which constitute significant avenues through which inequality is altered, different outcomes were discovered. These findings imply that policymakers in developing countries should create proper FDI attractiveness policies that stimulate trade openness and immigration were order to decrease income disparity.

Arestis, P., (2023) studied the effects of FDI flow openness on distribution across 27 European nations between 2007 and 2013 under various economic climates surrounding the Great Recession. It were able to combine data at the national level with socio demographic traits of specific individuals because to our multi-level methodology. The findings show that the openness of FDI flows has a diverse impact on how much money each group receives, favoring were particular the highest income classes. It appears to be influenced by educational attainment. Even though highly educated people were spread out across the entire income distribution, it was suggested, the openness of FDI flows favored the top income classes in particular. Regardless of the economic climate, the openness of FDI flows was a biased distributional effect that endures over the years analyzed were partly because the distribution of highly educated individuals is not sensitive to the business cycle.

Licong, H., et al., (2023) discussed income inequality in recent decades was limited the possibilities for economic improvement. The study looked at the effects of economic globalization on income inequality were both a cross-country and country-specific context using panel data approaches and policy simulations. The show that globalization often reduced inequality in advanced countries while was the opposite effect in low-income ones. Income inequality is negatively impacted by trade while being positively impacted by FDI, which helps to reduce income inequality across the board. It was shown that FDI had a greater impact on reducing income inequality. The policy simulations show how India could reduce income inequality by adopting middle- and high-income countries' policies. Given the considerable variation were stated econometric estimations, drawing trustworthy conclusions is difficult. The relationship between globalization and inequality was quantified and examined in the paper using a new dataset that contains 1,254 observations from 123 original studies.

Wang, E. Z., & Lee, C. C. (2023) discussed concerning the relationship between inequality and foreign direct investment (FDI), and it was accepted that the relationship were to be reexamined from a fresh angle. The research estimates a finite mixture model with country risk as a concomitant variable to explore the interrelationships among FDI, inequality, and country risk in order to provide new insight into the FDI-inequality nexus using balanced panel data made up of 60 countries from 1998 to 2014. The available data indicates a strong impact of composting country risk on it. In particular, FDI worsens inequality when there is a high level of risk, whereas it lessens inequality when there is a low level of risk in the country. Additionally, by taking into account the significance of nation risk components (economic risk, financial risk, and political risk) as a factor for the FDI-inequality nexus, was also get to the same conclusions. In countries with high political, economic, and financial risks, FDI worsens inequality, whereas it lessens inequality were those with low political, economic, and financial risks.

Ali, M. A., & Kamraju, M. (2022) conducted the research that was being presented looks at how wages and employment are affected by FDI in developing nations. The complicated relationship between FDI inflows and labor market outcomes were understood through the analysis of empirical data and theoretical frameworks. The study examines the benefits and drawbacks of FDI, including differences in sectoral/regional performance, wage levels, skill development, and spillover effects. The article offers policy recommendations for attracting FDI and fostering inclusive growth by taking into account elements including labor market flexibility, human capital development, and institutional environment.

Bogliaccini, J. A., & Egan, P. J. (2017) presented Cross-national contexts were used to study the relationship between inward foreign direct investment (FDI) and within-country income inequality, but empirical research into the potential effects of FDI in various sectors on inequality was not done. 41 middle-income countries were included in the investigation, which used error correction models to examine sectoral FDI data obtained from UNCTAD investment reports from 1989 to 2010. The authors argued that FDI in services was more likely to be connected with inequality than FDI in other sectors. The contend that these results can be explained by skill biases and changes in employment patterns linked to investments in the service sector.

Wu, J. Y., & Hsu, C. C. (2012) conducted the relationship between income inequality and FDI was outlined in rigorous empirical literature. Using a cross-sectional data set collected from 54 countries between 1980 and 2005, the research examines the effects of foreign direct investment (FDI) on income inequality and investigates whether the relationship depends on absorptive ability or not. In our sample, there was clear proof of a two-regime split thanks to the adoption of the endogenous threshold regression model. The income distribution of those host countries with low levels of absorptive ability is likely to suffer as a result of such FDI. However, lend credence to the idea that FDI was little impact on income disparity in the case of nations with more absorption capacity. International commerce was also proven to were the contributed to a more equitable distribution of income.

Adegbite, E. O., & Ayadi, F. S. (2011) examines the connection between foreign direct investment and Nigeria's economic expansion. The need were the study arose from the fact that since 1999, civilian governments in Nigeria was used a number of tactics to assure an increase in the flow of FDI into the country due to its alleged advantages, which are extolled in the theoretical literature as the solution to economic underdevelopment. To find the best linear unbiased estimators, the study used simple OLS regression analysis and several econometric tests on our model. The impact of FDI on growth, however, might be constrained by human capital. According to the study's findings, FDI does definitely support economic growth, necessitating more infrastructure investment, a stable macroeconomic environment, and the development of human capital in order to increase FDI productivity and flow into the nation.

Figini, P., & Go¨ rg, H. (2011) presented the study from 1980 to 2002, a controlled panel of more than 100 nations was used to examine the connection between foreign direct investment (FDI) and wage disparity. In accordance with a theoretical debate, it was important to evaluate in particular whether the relationship were non-linear. It concludes that the impact of FDI varies depending on a country's level of development; two distinct patterns are shown, one for OECD (developed) countries and the other for non-OECD (developing) countries. The point to the existence of a nonlinear effect in emerging nations; pay inequality rises in correlation with FDI inflow stock, but the effect weakens as FDI expands further. There was strong evidence that the relationship between FDI inflow and pay disparity in industrialized nations is non-linear.

Rais, A. (1997) studied the conclusion that there was still a significant demand for foreign direct investment was the Indian economy's various economic sectors, particularly the agriculture sector. The government of India should take steps to attract 100% of FDI to the country, which receives approved periodically. The Indian government should assure international enterprises that was business agreements were not be negatively impacted by the volatility of the government and that they can enter the Indian market with complete confidence.

3. Methods and Methodology

Research Methodology is a technique for analytically addressing research issues. It might be thought of as the study of scientific research methodology. The study examined the many procedures a researcher often uses to explore the study and the reasoning following them.

The nature of the research might be described as descriptive and exploratory. In order to complete the goals of the study, “both qualitative and quantitative research approach” was utilized. The study utilized “primary and secondary data collection methods” in conjunction to determine the “Role of Foreign Direct Investment in shaping income Inequality in Developing Economies: A cross-country Analysis.” However, it would take 385 respondents to complete the questionnaire. The questionnaire was used to collect primary data for the study, which is constructed according to “the 5-point Likert scale,” is used as the main approach for the data gathering process. On the Likert scale with five points, one point is awarded for severely disagreeing, two points are awarded for disagreeing, three points are awarded for neutral (neither agreeing nor disapproving), four points are awarded for agreeing, and five points are awarded for strongly agreeing. The study takes place in various countries in Global basis. Economies of India, china, Brazil were the study's target population. They were chosen with the help of random sampling method while the secondary data was chosen as non-random sampling method. In addition, the author read other pieces of literature, such as books, articles, and periodicals, in order to gather secondary data. After then, the data were evaluated using a wide variety of tools and procedures. Excel, which is made by Microsoft, and SPSS, which is made by IBM, is the statistical program that is used to examine the information. The statistical methods that are utilized at this point include the mean, the standard deviation, correlation, and ANOVA. The conclusions that may be drawn from these findings are presented in the following text and then addressed.

4. Research Objectives

- To examine the relationship between Foreign Direct Investment (FDI) and income inequality in a diverse set of developing economies.

  To investigate whether the impact of FDI on income inequality varies across different regions of developing economies.

5. Result Analysis

H1: There is significant relationship between Foreign Direct Investment (FDI) and income inequality in a diverse set of developing economies.

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Table 1: Descriptive Statistics

Descriptive Statistics			
	Mean	Std. Deviation	N
Foreign Direct Investment	27.10	4.506	385
Income inequality	21.45	4.011	385

The above table 1 defines the descriptive statistics of the Foreign Direct Investment and Income inequality. The mean score of Foreign Direct Investment is 27.10, the score of Income inequality is 21.45.

Table 2: Correlations

Correlations			
		Foreign Direct Investment	Income inequality
Foreign Direct Investment	Pearson Correlation	1	.126*
	Sig. (2-tailed)		.014
	N	385	385
Income inequality	Pearson Correlation	.126*	1
	Sig. (2-tailed)	.014	
	N	385	385
*. Correlation is significant at the 0.05 level (2-tailed).			

The above table-2 shows that the relationship between Foreign Direct Investment and Income inequality are statistically significant. The correlation is positive (0.126), which suggests a positive relationship between Foreign Direct Investment and Income Inequality."Severe (smartphone addiction)" has the highest Beta value (0.126), as Foreign Direct Investment increases, Income Inequality tends to increase as well.

H2: The effect of Foreign Direct Investment (FDI) on income inequality is not uniform across all regions within developing economies.

Table 3: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.199a	.040	.032	3.458

a. Predictors: (Constant), China, Brazil, India

Table 3 defines the model summary, indicating a significant degree of connection. The "R- value for the simple correlation is 0.199," which reflects how much of the overall variance in the dependent variable, the impact of **China, Brazil, India** on Foreign Direct Investment.

Table 4: ANOVA

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	188.204	3	62.735	5.247	.001b
	Residual	4555.785	381	11.957		
	Total	4743.990	384			
a. Dependent Variable: Foreign Direct Investment						
b. Predictors: (Constant), China, Brazil, India						

The ANOVA table-4 suggests that the regression model, which includes the independent variables (likely China, Brazil, India), is statistically significant (p = 0.001). This means that there is evidence to suggest that the independent variables have a significant effect on the dependent variable (Foreign Direct Investment).

Table 5: Coefficients

Coefficients						
Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	14.485	1.667		8.691	.000
	Brazil	.103	.052	.099	1.960	.041
	India	.105	.048	.110	2.173	.030
	China	.106	.047	.115	2.279	.023
a. Dependent Variable: Foreign Direct Investment						

The table-5 presents the coefficients for a linear regression model, along with their significance levels. It suggests that the variables "Brazil," "India," and "China" are all statistically significant in explaining variations in the dependent variable, given their low p- values for Brazil, the p-value is 0.041 (less than 0.05), suggesting that it is statistically significant at the 0.05 level, for India, the p-value is 0.030 (less than 0.05), indicating that it is statistically significant at the 0.05 level, for China, the p-value is 0.023 (less than 0.05), indicating that it is statistically significant at the 0.05 level (all less than 0.05). The standardized coefficients (Beta) allow comparing the relative importance of each independent variable in the model.

6. Conclusion

The research aimed to accomplish two primary objectives. Firstly, study sought to examine the relationship between Foreign Direct Investment (FDI) and income inequality in a diverse set of developing economies. Secondly, study aimed to investigate whether the impact of FDI on income inequality varies across different regions within developing economies. The findings shed light on several important aspects of this complex relationship:

Objective 1: The analysis revealed a significant relationship between Foreign Direct Investment (FDI) and income inequality in the examined developing economies. The positive

correlation coefficient (0.126) indicates that as FDI increases, income inequality tends to increase as well. This result underscores the need for policymakers to consider the potential consequences of FDI on income distribution, particularly in the context of developing economies.

Objective 2: Study found that the effect of Foreign Direct Investment (FDI) on income inequality is not uniform across all regions within developing economies. This suggests that the impact of FDI is influenced by regional factors and economic conditions. For example, the coefficients for China, Brazil, and India in our regression model indicate that these countries have varying degrees of influence on FDI and, consequently, on income inequality. These differences emphasize the importance of tailoring policies to the specific characteristics of individual regions within developing economies.

In summary, the study contributes to the understanding of the intricate relationship between FDI and income inequality in developing economies. The findings highlight the importance of considering regional variations when designing policies that aim to attract foreign investment while mitigating the potential negative effects on income distribution. Future research may delve deeper into the mechanisms through which FDI impacts income inequality and explore targeted policy interventions to promote more equitable economic development.

This research journey encourages scholars and policymakers to build upon these findings to develop evidence-based strategies for fostering sustainable and inclusive economic growth in developing economies. Addressing income inequality is a pressing global challenge, and understanding the role of FDI is a crucial step toward finding effective solutions.

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