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The Role of Inward FDI in Developing Countries

Focus on Economic and Human Development Outcomes

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Bachelor's thesis
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Abstract

The role of inward foreign direct investment (FDI) in the economic and human development of developing countries remains one of the most debated questions in international economics. Despite the exponential growth of FDI inflows to developing economies over recent decades, the true developmental impact of these flows is far from straightforward. This thesis examines the complex role of inward FDI in the economic and human development of developing countries through a literature review of empirical research.

The thesis addresses two sub-questions. First, what are the economic outcomes of inward FDI? Second, what are the human development outcomes of inward FDI? The economic outcomes are examined at both the macroeconomic and microeconomic levels, covering economic growth, domestic investment effects, firm productivity, and spillover effects. The human development outcomes are examined through labour-market outcomes, including income distribution, employment, and working conditions, as well as societal outcomes covering population health, education, and poverty and living standards.

The findings reveal that inward FDI's developmental impact is deeply conditional and context dependent. At the microeconomic level, foreign-owned firms consistently outperform domestic firms in productivity and wages, yet these firm-level advantages do not reliably translate into broader macroeconomic development. The causality between FDI and economic growth remains largely unresolved, and the constant repatriation of profits by multinational enterprises limits the value that actually reaches the host population. The human development outcomes follow an equally complex pattern, where FDI generates employment and raises wages, but the gains tend to flow disproportionately to the already skilled and educated labour force, potentially deepening existing inequalities.

This thesis concludes that inward FDI functions less as a reliable development catalyst and more as an amplifier of existing conditions. Where institutions are strong, human capital sufficiently developed, and linkages with the host economy deep, FDI accelerates development. Where these foundations are weak, FDI often reinforces structural vulnerabilities rather than resolving them. Nearly every positive effect of inward FDI identified in both economic and human development was matched by a corresponding negative effect, suggesting that the countries that need development the most are those for whom FDI works the least reliably.

Keywords: foreign direct investment, inward FDI, developing countries, economic development, human development, spillover effects, labour-market outcomes, societal outcomes

Kandidaatintutkielma

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Tiivistelmä

Kehittyviin maihin suuntautuvien suorien ulkomaisten investointien rooli niiden taloudellisessa ja inhimillisessä kehityksessä on yksi kansainvälisen taloustieteen kiistellyimmistä kysymyksistä. Vaikka suorien ulkomaisten investointien määrä on kasvanut eksponentiaaliesti kehittyviin talouksiin viime vuosikymmeninä, on näiden virtojen todellinen kehitysvaikutus kaukana yksiselitteisestä. Tämä tutkielma tarkastelee kehittyviin maihin suuntautuvien suorien ulkomaisten investointien roolia taloudellisessa ja inhimillisessä kehityksessä kirjallisuuskatsauksen muodossa.

Tutkielma vastaa kahteen osakysymykseen. Ensiksi, mitkä ovat kehittyviin maihin suuntautuvien suorien ulkomaisten investointien taloudelliset vaikutukset? Toiseksi, mitkä ovat sen inhimillisen kehityksen vaikutukset? Taloudelliset vaikutukset tarkastellaan sekä makro- että mikrotaloudellisella tasolla kattaen talouskasvu, kotimaiset investointivaikutukset, yritysten tuottavuus sekä spillover-vaikutukset. Inhimillisen kehityksen vaikutukset tarkastellaan työmarkkinavaikutusten kautta, mukaan lukien tulontaso, työllisyys ja työolot, sekä yhteiskunnallisten vaikutusten kautta kattaen väestön terveys, koulutus sekä köyhyys ja elintaso.

Tulokset osoittavat, että suorien ulkomaisten investointien kehitysvaikutukset ovat poikkeuksetta ehdollisia ja kontekstisidonnaisia. Mikrotaloudellisella tasolla ulkomaiset yritykset suoriutuvat johdonmukaisesti kotimaisiin yrityksiin verrattuna paremmin tuottavuuden ja palkkojen osalta, mutta nämä yritystason edut eivät luotettavasti heijastu laajempaan makrotaloudelliseen kehitykseen. Syy-seuraussuhde suorien ulkomaisten investointien ja talouskasvun välillä on edelleen pitkälti ratkaisematon, ja monikansallisten yritysten jatkuvat voitonsiirrot kotimaihinsa rajoittaa sitä, kuinka suuri osa näiden investointien tuottamasta lisäarvosta saavuttaa isäntämaan väestön. Inhimillisen kehityksen vaikutukset noudattavat yhtä lailla monimutkaista kaavaa, jossa suorat ulkomaiset investoinnit luovat työpaikkoja ja kasvattavat palkkoja, mutta hyödyt virtaavat suhteettomasti jo valmiiksi koulutetulle työvoimalle, syventäen olemassa olevia eriarvoisuuksia.

Tutkielma päättelee, että kehittyviin maihin suuntautuvat suorat ulkomaiset investoinnit toimii pikemminkin olemassa olevien olosuhteiden vahvistajana kuin luotettavana kehityksen katalysaattorina. Siellä missä instituutiot ovat vahvoja, inhimillinen pääoma riittävän kehittynyttä ja yhteydet isäntämaan talouteen syvät, suorat ulkomaiset investoinnit kiihdyttävät kehitystä. Siellä missä nämä edellytykset ovat heikot, vastaavat investoinnit pikemminkin vahvistavat rakenteellisia haavoittuvuuksia kuin ratkaisee niitä. Lähes jokaista tunnistettua positiivista vaikutusta vastaan on havaittavissa vastaava negatiivinen vaikutus, mikä viittaa siihen, että maat, jotka tarvitsevat kehitystä eniten, ovat niitä, joille FDI toimii vähiten luotettavasti.

Avainsanat: suorat ulkomaiset investoinnit, kehittyvät maat, taloudellinen kehitys, inhimillinen kehitys, spillover-vaikutukset, työmarkkinavaikutukset, yhteiskunnalliset vaikutukset

TABLE OF CONTENTS

FIGURES

1 Introduction

1.1 Background of the study

Bazile et al. (2024, 2) portrays inward foreign direct investment (FDI) as the "Horn of Amalthea" – a mythical source of capital, wealth and long-term growth for developing countries. And it is clear, that FDI has become a key component of globalisation, and inflows to developing countries have grown exponentially for decades. Over the period 1990–2024, developing economies' share of global FDI inflows increased from 17% in 1990 to over 57% in 2024 (UNCTAD, 2025), indicating a strong reorientation of FDI inflows towards developing host countries. These FDI inflows have also been described as the "good cholesterol" of globalisation and are often viewed as a more stable and preferable form of finance than short-term capital flows (Hausmann & Fernández-Arias, 2000, 3–4; Epstein, 2019, 165). However, the true impact of FDI on host countries is far from straightforward and remains one of the most debated questions in international economics (Epstein, 2019, 165; Hintošová, 2021, 1026).

Based on a deep econometric analysis in 2015, fewer than half of the reported estimates (43%) find a positive and statistically significant relationship between inward FDI and host-country growth, while 17% indicate a negative and statistically significant relationship (Iamsiraroj & Ulubaşoğlu, 2015, 200–201). FDI's role in growth and development is complex, and investors' own interests may not align with the host country's development objectives (Hintošová, 2021, 1026–1027). However, it should be acknowledged that FDI's effect on economic and human development is conditional, as it also depends on the host country's absorptive capacity, such as the level of human capital and the quality of institutions. (Chowdhury & Mavrotas, 2006, 10; Bazile et al., 2024, 2).

Especially in developing countries, FDI is often expected to accelerate both economic growth and human development, and governments pursue to attract foreign capital through a variety of policy instruments and changes. Yet, the gains from inward FDI are not shared evenly across society, and some groups may not benefit at all, despite the common expectations. And although foreign firms almost invariably exhibit higher productivity than domestic firms and pay higher wages, it is unsure if these firm-level benefits translate into improvements in the development of the national welfare. (Lipsey, 2004, 357, 369; Hintošová, 2021, 1030.)

The significance of research on developing countries is extremely important, as the answer to the question regarding the true impacts of FDI touches the lives of hundreds of millions – if not billions – of workers, families, and communities (Moran et al., 2005, 1). Foreign direct investments are not

merely financial transactions, they are also recognised as crucial mechanisms in achieving significant global human development goals in poverty reduction and the financing of social safety nets (Chowdhury & Mavrotas, 2006, 10). Therefore, examining the role of inward FDI is not only of academic interest but also carries profound ethical and human weight.

This thesis focuses on developing countries because, in 2014, FDI flows to developing countries surpassed FDI flows to developed countries (Hintošová, 2021, 1032). Inward FDI is also one of the most important drivers of economic growth in these countries, yet they are also extremely vulnerable to potential negative outcomes (Bazile et al., 2024, 11), making it particularly important and topical to examine the outcomes in this context. This thesis defines developing countries according to UNCTAD's (2025) classification, which broadly comprises economies in Africa, Latin America, Asia, the Caribbean, and Oceania, while excluding, Japan, Israel, the Republic of Korea, Australia and New Zealand. This delimitation is necessary for interpreting the statistics reported in this thesis.

1.2 Aim and structure of the thesis

The aim of this thesis is to examine the complex role of inward FDI in the economic and human development of developing countries. This thesis focuses exclusively on the development outcomes of inward FDI – identifying, assessing, and interpreting them, by analysing empirical literature and recent research. Accordingly, it is strictly scoped to examine the consequences of FDI rather than its determinants and seeks to form a comprehensive and clear understanding on inward FDI's role in development in developing countries. To address this aim, the thesis examines the topic through two sub-questions, which analyse the effects of inward FDI from different perspectives.

The first sub-question is: *What are the economic outcomes of inward FDI?* This question explores the outcomes of inward FDI at both the firm and macroeconomic levels. The discussion considers key dimensions of economic performance, such as growth, income levels, and productivity. The second sub-question is: *What are the human development outcomes of inward FDI?* This question focuses on inward FDI's societal effects at the individual level and examines how they relate to key dimensions of development, including socioeconomic outcomes, health, education, and living standards. This thesis equally assesses factors that may either promote or hinder the economic or human development of the host country and seeks to determine if inward FDI truly is the "Horn of Amalthea" (Bazile et al., 2024, 2) or just wishful thinking.

This thesis is structured into five main chapters. Following the introduction, Chapter 2 provides the theoretical foundation by defining FDI, including its main entry modes, and other key concepts such as FDI flows and inward FDI. Chapters 3 and 4 form the analytical core of the thesis and examine the economic and human development outcomes of inward FDI in developing countries, addressing the sub-questions of the thesis. Chapter 3 focuses on both macroeconomic and microeconomic outcomes, including economic growth, effects on domestic investments, firm productivity, and spillover-effects. Chapter 4, in turn focuses on human development outcomes, covering labour-market outcomes such as income distribution and employment, as well as broader societal outcomes including population health, education, and poverty reduction. Finally, Chapter 5 presents the conclusions of the thesis by synthesising the key findings and outlining directions for future research.

2 Inward Foreign direct investment

2.1 Definition and key concepts

Foreign direct investments are a category of cross-border investments made by a resident of an economy in order to establish an enduring interest in an enterprise that is resident in a foreign economy relative to the direct investor. The investing enterprise engaging in FDI seeks to achieve a strategic long-term relationship with the direct investment enterprise to ensure a substantial influence in the management of the direct investment enterprise. A cross-border investment needs to acquire the direct investor at least 10% of the voting power of the direct investment enterprise to be classified as FDI. (Organisation for Economic Co-operation and Development [OECD], 2025, 32.)

In general, foreign direct investment is defined as capital flows from home country to a host country. These FDI inflows are typically undertaken through three main instruments: equity capital, intercompany debt and reinvested earnings. FDI is an extremely important component of the global economy and one of the most visible indicators of economic globalisation. It affects employment, technological development, and, ultimately, economic growth. To understand FDI and this thesis, it is crucial to acknowledge the differences from foreign portfolio investment (FPI). Portfolio investments, unlike FDI, have shorter time horizons and are often made for more speculative purposes, rather than engaging in long-term development or company growth. (Jensen, 2003, 587–589.) The most common actors undertaking FDI are large *multinational enterprises (MNEs)*, as FDI entails substantial and often irreversible resource commitments with returns that are realised over longer time horizons (Strange, 2018, 1229–1231).

A commonly used indicator of an economy's ability to attract foreign capital is FDI inflow, which is defined as the inward movement of foreign direct investment into the host country. (Jensen, 2003, 597). The inflow concept is frequently measured as net FDI inflows as a percentage of gross domestic product (GDP). This variable focuses on inward FDI and is therefore believed to be a more suitable indicator for host-country attractiveness than broader measures that also incorporate domestic capital invested abroad. Net FDI inflow measures can also report negative values, indicating a net withdrawal of investments by MNEs. (Jensen, 2003, 589–597.)

2.2 FDI entry modes and their developmental implications

Although most FDI research treats FDI as a uniform variable, it is important to understand the definitions and key characteristics of these modes, as they are closely associated with differing

outcomes. The effects of different entry modes on economic growth, employment, and human development vary considerably across developing countries. For example, the findings of Harms & Méon (2014) on these varying effects support the idea that the quality of FDI is at least as important to the host country as its quantity.

Greenfield FDI is defined as an entry mode in which the foreign investor creates a totally new operation in the host economy, for example by constructing a new plant or a new operational facility, rather than entering an economy through the purchase of an existing domestic firm (Raff et al., 2009, 3–4; Qiu & Wang, 2011, 836; Ha et al., 2021, 4). Greenfield FDI is particularly important for developing countries, where capital stock growth is a key factor for development and since these operations are built from scratch, greenfield investments are more strongly associated with job creation (Wang & Wong, 2009, 316–321). When a greenfield project is implemented in a foreign developing country, establishing the operation typically also requires the transfer of substantial knowledge and assets to the host country, which creates possible positive spillovers. Greenfield investment is considered more suitable entry mode in markets with low competitive pressure and high percentage of them are undertaken in developing countries. (Klimek, 2011, 61-66.) Empirical evidence shows that greenfield investment is positively and significantly related to economic growth. A 1% increase in greenfield investment in developing countries leads to an 0.145 percentage point increase in GDP. (Wang & Wong, 2009, 321–324.)

Cross-border mergers and acquisitions (M&As) are transactions involving an acquirer firm from a certain home country and a target firm with headquarters located in a foreign host country. In the FDI context, M&As serve as an equity-based entry mode. M&A as an entry enables an acquiring firm to obtain the already existing resources of a target business while including its own technology, human capital, and knowledge base, gaining immediate access to local markets and key constituencies. (Shimizu et al., 2004, 309-311.) M&As are less beneficial for development because they often stay transfers of ownership without new production creation. M&As can also lead to cuts in labour-force or closure of operations. (Wang & Wong, 2009, 317.) In contrast, they have major developmental effect as a primary driver for FDI inflows through the privatisation of state-owned enterprises in emerging markets. M&As also integrate these host country entities into larger international networks. (Klimek, 2011, 61-63, 68.) In developing countries M&As can only promote growth if the host country has sufficient human capital (Wang & Wong, 2009, 323–324).

An international joint venture (JV) is a venture involving two or more legally distinct enterprises where at least one company is headquartered outside the venture's operational host country. The

collaborating firms in these joint ventures each actively participate in the decision-making activities of the jointly owned separate entity. (Geringer & Hebert, 1989, 235.) From the host country's perspective, a primary developmental effects of cross-border joint JVs are the transfer of technology including the acquisition of new technical and managerial skills for the local partner, as well as resource sharing, allowing the local host country entities to access the financial strength, broader expertise, and international workloads of an MNE partner (Ozorhon et al., 2007, 799–801).

3 Economic outcomes of inward FDI

3.1 Macroeconomic outcomes

3.1.1 Economic growth: Cause or Correlation?

FDI's impact on the economic growth of a host country is one of the most studied, yet controversial, topics in international economics (Iamsiraroj & Ulubaşoğlu, 2015, 201; Ross & Fleming, 2023, 508). Theoretically, FDI is expected to accelerate economic growth by increasing physical capital, transferring technology, and improving human capital (Iamsiraroj & Ulubaşoğlu, 2015, 201; Lipsey, 2004, 336). A broad econometric analysis including samples from 140 developing countries reveals that only 43% of studies find a statistically significant and positive relationship between FDI and host country's economic growth. According to research, it is estimated that in the global sample a one percentage point increase in the FDI to GDP ratio is associated with, on average, 0.23% higher economic growth. Interestingly, it has also been found that current FDI – rather than lagged FDI – is the factor with the strongest positive association with economic growth. (Iamsiraroj & Ulubaşoğlu, 2015, 200–201, 207, 212.) The findings also indicate that the economic growth outcome of FDI depends crucially on which sector the investment is directed to (Ullah et al., 2023, 1; Emako et al., 2022, 382).

FDI inflows towards the industrial sector has been shown empirically to be the strongest and most consistent driver of growth in developing countries (Emako et al., 2022, 394–396; Ullah et al., 2023, 13). For example, using data from 19 developing countries, industrial-sector FDI has been found to generate a 0.022% increase in host country's GDP growth from one percentage point increase in investment. This is linked to this sector's capacity to create extensive backward and forward linkages with the local economy. (Emako et al., 2022, 395–396.) Ullah et al. (2023, 9–10) also found in their regression model that the growth-enhancing effect of industrial FDI was as high as a coefficient of 0.642.

In contrast, FDI inflows to the tertiary sector has been found to have a significant negative effect on economic growth of a developing host country. In the tertiary sector, the estimated growth responsiveness has been observed to be -0.068%, which indicates that service FDI weakens the economic growth of the host country. (Emako et al., 2022, 395–396.) Chakraborty and Nunnenkamp (2008, 1197) link this effect to the dominance of M&As over greenfield in the service sector, causing significant crowding-out potential that foreign service providers possess owing to their superior market power, which leads to the displacement of local firms (Emako et al., 2022, 396). However,

this view is also debated in the literature, as in another recent research Jana, Sahu, and Pandey (2019, 53–67), who argue that service-sector FDI exerts a profoundly positive effect on economic growth. They found this impact to be driven by the sector's high technology base, operational sophistication, and the involvement of trained and skilled labour. They also found services to be less dependent on finite natural resources and typically feature a shorter payback period on the investments, allowing faster contributions to the host country's output. (Jana et al., 2019, 53–67.)

FDI towards primary sector, such as mining and agriculture, often causes negligible or negative growth effects (Emako et al., 2022, 382). These investments are frequently concentrated to isolated "enclaves" and because of this, offer minimal spillover effects to the rest of the economy (Lipsey, 2004, 358; Ullah et al., 2023, 12). For instance, in Nigeria, FDI has been found to correlate negatively with growth in both the agricultural and manufacturing sectors (Emako et al., 2022, 385).

One of the most significant negative macroeconomic consequences on economic growth caused by FDI, is the massive repatriation of profits to the home country by the parent company, which hinders the host country's balance of payments and prevents value-added from remaining within the local economy (Hintošová, 2021, 1030; Iamsiraroj & Ulubaşoğlu, 2015, 202). The repatriation of profits creates a significant barrier to long-term income growth from FDI in developing countries. If a major portion of the value added created by a foreign investment is transferred straight back to the home country rather than being reinvested locally, the growth in a host country 's GDP will not be reflected in its gross national income (GNI). (Sumner, 2005, 279.) To attract FDI, developing countries may also enter into a "race to the bottom," where the public costs of providing investment incentives, such as tax reliefs, exceed the economic benefits that FDI generates itself (Hintošová, 2021, 1031). FDI has also been found to slow growth in countries suffering from high inflation, which is often typical for developing countries (Alguacil et al., 2011, 492; Joo et al., 2022, 256).

According to Minh and Trinh (2023, 218), the impact of FDI on economic growth follows the law of diminishing marginal returns. Which means that when a host country receives very large amounts of foreign capital, each additional unit of investment produces proportionally less additional growth. Their research has identified that when FDI inflows exceed 6.275% of GDP, their positive effect on economic growth begins to weaken significantly (Minh & Trinh, 2023, 218–224). The broad question on whether FDI causes economical growth or is just a result of it remains somewhat unresolved still in macroeconomic literature. In Chile, it has been found that GDP growth causes FDI flows, but FDI does not cause growth. In contrast, the relationship has been found to be bidirectional in Malaysia and Thailand, where growth and investment reinforce each other. These findings suggest that in many

cases, FDI is a reward for already achieved economic success rather than being its primary engine . (Chowdhury & Mavrotas, 2006, 10–18.)

Figure 1 illustrates the development of GDP growth (annual %) and inward FDI inflows (% of GDP) in low- and middle-income countries between 2001 and 2025. The data is obtained and modified from the World Bank's World Development Indicators database (World Bank, 2025). In this thesis, low- and middle-income economies are used as a proxy for developing countries, as this classification is commonly applied in empirical research examining developing countries. While the figure provides a clear overview of FDI inflows and economic growth in developing countries, it does not imply a noticeable causal relationship between the variables. Rather, it reinforces the debate on whether FDI drives economic growth or whether it is a consequence of it and illustrates how both indicators are influenced by broader economic conditions. However, the figure appears to show some degree of association between the two variables at several points in time.

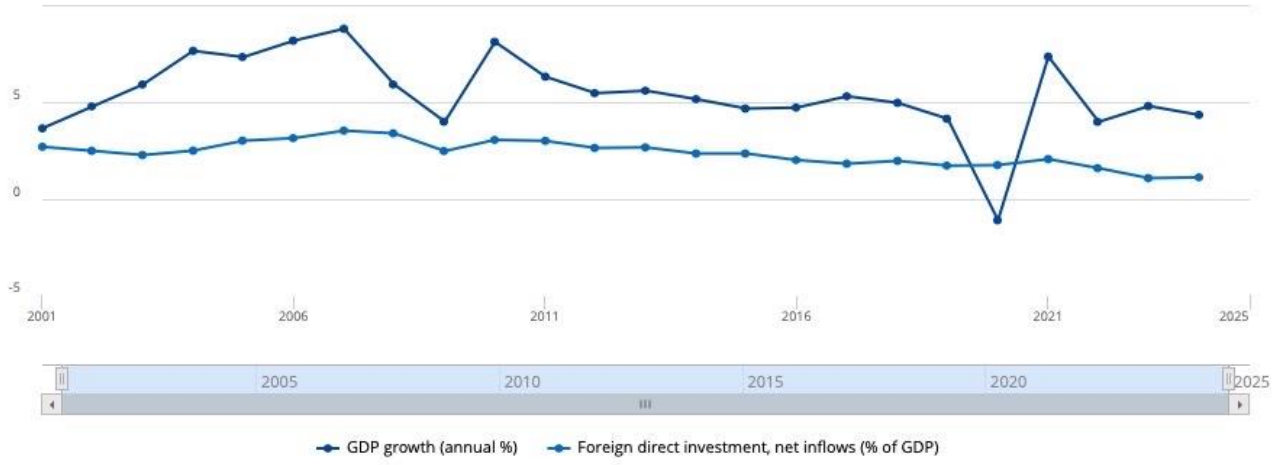

Figure 1 GDP growth and inward FDI inflows (% of GDP) in low- and middle-income countries, 2001–2025 (World Bank, 2025)

The effects of FDI on the economic growth in developing countries depend strongly on the receiving sector and the country's stage of development, as well as on the type of FDI entry mode and the home country of the investing firm. For example, greenfield investments significantly promote growth because they directly increase the host country's physical capital stock (Harms & Méon, 2014, 9–11; Wang & Wong, 2009, 317, 330). In contrast, M&As do not necessarily increase the capital stock but more often represent a transfer of ownership, which has been observed to have a negative relationship with economic growth (Wang & Wong, 2009, 317; Harms & Méon, 2014, 1). M&As consistently lead to the closure of local production units and real currency appreciation, which inevitably weakens

the developing host country's export competitiveness (Harms & Méon, 2014, 15–16; Emako et al., 2022, 386). As mentioned, recent research also shows that the origin of the investor matters, as Chinese foreign direct investment (CFDI) has been found to have continuously a statistically significant negative effect on host countries' economic growth (Ross & Fleming, 2023, 516–517).

3.1.2 Crowding-in vs. Crowding-out effects

In developing host countries, the relationship between inward FDI and domestic investment is heterogeneous and complex. The entry of MNEs can either create additional domestic investment, known as crowding in, or it can displace domestic investment, leading to a crowding out effect (Sumner, 2005, 277–278). FDI interacts dynamically with domestic investment, which is a crucial factor because it directly increases the host country’s stock of physical capital (Sumner, 2005, 277-278; Wang & Wong, 2009, 324). Examining the direct financial relationship, research has found a clear positive and one-for-one relationship between the US dollar value of FDI and the US dollar value of domestic investment (Sumner, 2005, 276–278).

The crowding impact on domestic investment vary significantly across different developing regions. In Asia, FDI have been generally found to crowd in domestic investment. Conversely, in Latin America, FDI predominantly crowds out domestic investment. And in Africa, evidence indicates a one-for-one relationship between FDI and domestic investment. (Agosín & Machado, 2005, 157–159.) This regional disparity is most likely due to differences in absorptive capacity and institutional quality, following the broader pattern that FDI outcomes are deeply conditional. According to Sumner (2005, 278), UNCTAD (1999b) identified crowding out effects in 19 and crowding in effects in 10 of 39 sample developing countries. The same report highlighted strict regional divisions, finding no crowding in across 12 Latin American countries and no crowding out across 12 Asian countries.

Crowding in typically occurs if the economic sector is underdeveloped, while crowding out occurs more often when the domestic firms are already developed (Agosín & Machado, 2005, 151). The financial advantages that MNEs may hold over domestic firms in developing markets can create an incentive to invest to these markets, while also allowing foreign investors to avoid relying on weak or inefficient domestic financial markets (Hausmann & Fernández-Arias, 2000, 18–19).

Jude (2019, 164–166, 187) suggests that an initial competitive displacement of domestic investment can occur from inward FDI due to competition in real markets. It happens particularly when a large proportion of domestic demand is captured by foreign affiliates, resulting in local firms delaying or abandoning investment projects. However, this crowding effect could eventually weaken over time

as foreign affiliates become increasingly more integrated into the host country's economy, creating trade linkages with local firms. Host country's financial development is crucial in reducing crowding out pressures on domestic investors by improving the allocation of financial resources and increasing the availability of financing for domestic investors. (Jude, 2019, 164–166, 187.)

The crowding effects of FDI are highly country-specific, and neutrality is usually the typical outcome in the long run. This means that FDI may add to total investment stock without actually generating a sustaining increase in domestic investment beyond its own value. (Kamaly, 2014, 391–392.) Farla et al. (2016, 1–2) emphasise that empirical research has often produced mixed findings because domestic investment is difficult to measure accurately and because some studies rely on problematic proxies and estimation choices. It should also to be noted, that greenfield investments create new facilities whereas M&As involve buying an existing one, therefore estimating the effects on domestic capital formation using total aggregate FDI, would result in ambiguous estimates. (Wang & Wong, 2009, 324-327.)

3.2 Microeconomic outcomes

3.2.1 Inward FDI's effect on host country productivity

A fundamental microeconomic observation is that inward FDI directly elevates the aggregate productivity of developing host countries, because foreign MNEs consistently operate at higher efficiency levels than domestic firms (Vu et al., 2025, 374). Empirical evidence shows that labour productivity in foreign-owned plants can easily be almost twice as high compared to local plants. This productivity premium alone turns immediately into an enhancement of the host country's total factor productivity. MNEs usually introduce also more modern and advanced technologies, higher capital intensity, and larger scales of production that directly improve the technological capabilities of the host economy. (Lipsey, 2004, 355, 369–370.) Also, as MNEs build up information and communication technology (ICT) capital, it has a highly positive direct effect on local labour productivity in developing host countries where effective new technologies spread rapidly (Dimelis & Papaioannou, 2010, 86, 90).

The impact of FDI on a host country's overall productivity is strongly influenced by the local financial environment. In developing countries, local firms often suffer from tight credit limits and weaker financial markets, forcing them to maintain very high minimum efficiency just to survive. Because these MNEs are able circle around these local financial barriers through external funding, their presence keeps high aggregate productivity in the host country even if the local credit may be

restricted. As a result, the host country's economy enjoys a so-called "fatter tail" in its productivity distribution. Meaning that a larger number of highly productive companies operate within its borders, raising the overall efficiency of the local market. (Han et al., 2022, 1–11.)

The possible increase in host country's productive capacity depends heavily on the mode of entry and the targeted sector. As discussed earlier, greenfield investments directly increase host country productivity by establishing entirely new, technologically advanced facilities, which adds directly to the local physical capital stock (Wang & Wong, 2009, 316). The exceptionally high productivity recorded for M&A affiliates is partly a result of a selection bias, where foreign investors acquire domestic plants that are already highly productive (Lipsey, 2004, 357).

Usually, FDI in technology-intensive fields generates substantial direct labour productivity gains for the host country's economy (Son & Kim, 2025, 3–4), but investments towards the agricultural sector are as equally important. In agriculture sector, FDI directly helps to resolve the structural local bottlenecks in supply by introducing modern machinery and new management practices, which significantly elevates the host country's overall productivity (Xu et al., 2025, 2–3).

3.2.2 Knowledge and technology spillovers

In developing countries, the long-term benefits of inward FDI stretch beyond mere direct accumulation of physical capital. One of the most important ways that inward FDI contributes to economic growth occurs via the indirect transfer of knowledge, technology, and management practices to the host country's economy (Sahu, 2021, 376; Kokko, 1992, 19). These spillovers occur when MNEs affect the productivity or technological capabilities of local firms through their presence or market entry, without being able to fully capture the value of these benefits (Kokko, 1992, 19).

One of the most influential means of transferring technology to developing countries is by creating contractual vertical links between foreign affiliates and local firms (Reyes, 2017, 2–3). Backward linkages occur when MNEs purchase inputs from domestic suppliers, involving the direct transfer of knowledge, quality standards, and technical assistance to help local companies meet global production standards (Kokko, 1992, 42–43). The size of these linkage spillovers will depend greatly upon how well the developing host country is integrated into global value chains (GVCs). Developing countries that are primarily involved in backward GVC participation, utilising foreign inputs for their exports, are expected to experience the largest increases in complementary productivity improvements and local linkages from attracting FDI in low-tech sectors. On the other hand, developing countries that have higher levels of integration into forward GVC participation, supplying

components to third economies, will see the greatest increase in productivity from FDI in high-tech industries that require significant amounts of technology to be integrated into their operations (Son & Kim, 2025, 8–10.)

In addition to formal contractual arrangements, host countries also receive benefits from informal demonstration effects and labour turnover. Domestic firms may be able to mitigate the risks associated with independent innovation by observing and mimicking the technologies, managerial practices, and export strategies employed by foreign affiliates (Kokko, 1992, 27; Sokhanvar, 2025, 914). Furthermore, as foreign affiliates educate local workers on how to operate sophisticated systems, that process contributes to the development within the host country (Kokko, 1992, 48). After this knowledge is developed, it can spill over into the local market when trained workers transition to domestic firms or establish new enterprises (Vu et al., 2025, 373). However, as foreign competitors enter a host country, they disrupt pre-existing market balance and create more intense competition within the host country. As competition tightens, domestic firms may need to eliminate technical inefficiencies, known as X-inefficiencies, and utilise their existing resources more efficiently to remain competitive and maintain their market share (Kokko, 1992, 51–52.)

Positive spillovers are not guaranteed especially in developing countries. The realisation of these benefits is contingent upon the host country's absorptive capacity, defined as the host country's stock of human capital, the quality of its institutional structure, and the state of its domestic financial markets. The technological gap between the foreign affiliate and the local firm is a critical factor in this regard. Earlier frameworks assumed that a wider technological gap between foreign affiliates and domestic firms enhances the potential for learning and knowledge spillovers among local firms. However, recent empirical research suggests that when the technological distance to the technological frontier is too large, domestic firms lack the ability to absorb foreign knowledge. (Razzaq et al., 2021, 3–13). In such cases of extreme technological distance, foreign affiliates operate as isolated "enclaves", and do not develop any productive linkages with the host economy. In such cases, there will be no spillovers from the foreign affiliate to the host economy (Kokko, 1992, 169–173.)

The ability of domestic firms to internalise spillovers from FDI varies greatly. Most local firms in developing countries are unable to develop the necessary organisational dynamism to absorb foreign technologies or to raise the standard of their production to match that of foreign affiliates. Rather, most of the productivity benefits from FDI are realised by domestic high-growth firms that already have the absorptive capacity and flexibility to quickly internalise new knowledge through both demonstration and linkage channels. (Reyes, 2017, 2–4; Sokhanvar, 2025, 913.)

4 Human development outcomes of inward FDI

4.1 Labour-market outcomes

4.1.1 Income levels and distribution

The impact of FDI on host countries' income levels represents a critical pillar of development in this thesis. Developing countries are frequently stuck in a vicious cycle of underdevelopment, where low productivity generates low income. In this framework, FDI is often believed to be a potential external catalyst capable of breaking this cycle by flowing capital, advanced technology, and managerial expertise that the host country is unable to generate internally. (Emako et al., 2022, 383).

Empirical research on FDI consistently finds that MNEs tend to pay a wage premium. Foreign companies in developing countries consistently pay higher wages than their local counterparts, and the differences rise as high as 60 percent (Epstein, 2019, 169). This wage difference is caused by the fact that MNEs usually possess "firm-specific assets," such as superior technology and more efficient organisational structures, which typically require more skilled workforce (Lipsey, 2004, 334; Epstein, 2019, 169). MNEs also utilise higher wages as a strategic choice to attract the best talent available and to reduce worker turnover. The statistical significance of these differences in wages varies in developing countries, but for example in East-Asia foreign-owned firms tend to pay higher incomes on average. (Lipsey, 2004, 346–350.)

Beyond direct employment within foreign MNEs, FDI can trigger broader wage spillovers that affect the general income level of the whole host country or a host sector. Research in Indonesia, for instance, has shown that just the presence of the foreign capital in an industry tends to raise wages for workers also in domestic firms inside the same sector. This can be attributed to FDI's trait to increase the total demand for labour, forcing local competitors to raise their wages to satisfy and retain their employees. (Lipsey, 2004, 351.) However, these positive effects on incomes are often concentrated among white-collar or highly educated workers, which may thereby widen the income gap even further especially in developing countries (Lipsey, 2004, 351; Epstein, 2019, 169).

Although over 40% of research on FDI finds it to promote aggregate economic growth, its impact on income distribution and poverty reduction is more contentious. While macro-level studies often indicate a positive correlation between FDI and host country's average income, this growth is not always inclusive. In some countries, in Africa and Latin America, FDI has been found to exacerbate income inequality by primarily benefiting the middle and upper classes, leaving the poorest segments of the society further behind. (Sumner, 2005, 275–277.) The regional allocation of FDI also plays an

important role, as it tends to cluster in urban centres or skill-heavy sectors, which deepens the economic divide between urban and rural areas. For instance, in Mozambique's economy, FDI has fostered growth without consistently reducing poverty, highlighting the "social losses" that are traded off for "private gains" (Bazile et al., 2024, 13–14.)

The sectoral composition of FDI is a decisive factor determining that how much income actually remains within the host country. FDI in the manufacturing sector is widely considered to be most effective for raising income levels because it creates strong linkages with local suppliers and requires continuous labour training (Emako et al., 2022, 396). Whereas FDI in the primary sector, such as mining or oil, often is concentrated to previously mentioned "enclaves" with minimal interaction with the local economy, and in result provides limited benefits to the broader population (Emako et al., 2022, 394–396). The impact service sector still remains controversial, while some researchers highlight its technological sophistication (Jana et al., 2019, 53), others warn that it can more likely drive away local smaller entrepreneurs, resulting in a negligible or even negative net impact on domestic income (Emako et al., 2022, 395–396).

Ultimately, the ability of a developing country to translate FDI into higher income levels depends on its absorptive capacity, including human capital and financial development (Bazile et al., 2024, 2). Additionally, macroeconomic instability, such as high inflation, can flip the impact of FDI negative, as uncertainty inevitably prevents long-term income gains from accumulating (Alguacil et al., 2011, 484).

4.1.2 Employment effects

The question of whether FDI translates into beneficial impacts in societies of developing countries has become crucial, especially since 2010 when developing countries became the primary targets of FDI globally (Bazile et al., 2024, 4). Therefore, the impact of FDI on labour-market results – such as effects on employment – are directly relevant to the policy agenda. There is clear evidence on the upside of FDI's role on employment, as many developing countries have had their FDI sectors become major employers. For example, more than half of Malaysia's and Sri Lanka's manufacturing labour force are employed in MNEs through FDI. (Sumner, 2005, 281).

Some researchers find FDI to have a clear positive influence employment, while others indicate that FDI is detrimental to employment. From a macroeconomic perspective, investment decision-making determines increases in output and employment. Meaning that, increase in inward FDI would lead to more jobs, yet at the same time, labour inefficiencies could result from FDI, leading to decreased

employment levels. Due to the diversity of these results, many authors argue that developing countries need to be more selective when creating policies to encourage FDI. (Hakim et al., 2023, 158–159.)

Abor and Harvey (2008, 220) illustrate in their host-country employment research, why FDI does not automatically lead to massive job creation. For example, evidence from Ghana's manufacturing sector demonstrates that highly productive foreign MNEs usually choose technology-intensive methods of production over labour-intensive methods. As a result, these MNEs may maintain a small workforce, particularly in manufacturing labour. Market limitations can also restrict total production levels, and firms that achieve higher productivity may reduce their workforce to avoid overproduction and excess inventory. (Abor & Harvey, 2008, 214, 220.) Still, despite these contradicting results, in a recent meta-regression analysis, researchers have found that the genuine effect of FDI on the host countries' employment is positive. However, this overall positive effect usually remains somewhat shallow. (Hakim et al., 2023, 167–168, 177.)

4.1.3 Working conditions: "Sweatshops" or higher standards?

For decades, jobs created by FDI in developing countries have triggered debate around their often partly questionable working conditions. A primary source of controversy is the allegation that these MNEs take advantage of workers by making them work in so-called "sweatshop" conditions, which are defined by low wages and workspaces that are abusive, unhealthy, and unsafe (Brown, Deardorff, & Stern, 2004, 269). Critics claim that the mobility of international capital creates a "race to the bottom" for MNEs. This "race" encourages these companies to increase their profit margins through strategic changes, such as lowering wages, eliminating social protections, and lowering workplace standards. (Epstein, 2019, 165.) These problematic working conditions and the abuse of underdeveloped host-country regulations are most frequently seen in labour-intensive sectors, such as the manufacturing of footwear, clothes, toys, and sporting goods (Brown, Deardorff, & Stern, 2004, 280).

In contrast to the widely believed assumption that foreign investors actively seek out jurisdictions with poorly protected labour-rights and low social standards, empirical evidence actually proves otherwise (De Schutter, Swinnen, & Wouters, 2013, 23–24). Research indicates that high levels of core labour standards in the host country, can be positively associated with FDI, as strong worker rights are often a sign of political stability and can attract developmental FDI (Epstein, 2019, 175). Also, to protect their global reputations, MNEs often promote and transfer their most acceptable and modern practices in social and labour areas. Because of this, FDI can trigger a "climb to the top" rather than a "race to the bottom" regarding working conditions and non-economic indicators of

human development, such as labour standards. Overall, the presence of foreign investors can improve the developing host country's job quality also by raising the demand for skilled labour and introducing better workplace practices. (De Schutter, Swinnen, & Wouters, 2013, 23–24.) Foreign MNEs also typically offer overall safer workplaces than local firms in developing countries (Nagel et al., 2015, 659).

4.2 Societal outcomes

4.2.1 Population health effects

In research, population health is most commonly measured by using different indicators such as infant mortality rate and life expectancy (Chiappini et al., 2022, 2–3). The overall death rate is also a proxy used for population health measurements (Immurana et al., 2023, 2). The human development index is frequently used to measure the evolution of a society's welfare based on dimensions that include average life expectancy at birth (Forte & Abreu, 2022, 12632).

In Nagel et al.'s (2015, 663–664) comprehensive study including 179 countries, the relationship between FDI and health was found to be non-linear, and heavily dependent on the level of income in the host country. They found out that inward FDI has a positive effect on health especially at low-income countries, all of which are developing countries. For example, in Ethiopia, doubling inward FDI per capita reduces infant mortality rate by more than four children per 1000 live births, while it would increase infant mortality in wealthy countries. (Nagel et al., 2015, 663–664.)

When FDI generates economic growth, it allows more resources to be allocated towards education, healthcare, and infrastructure (Siddique et al., 2021, 84). By raising income, FDI also increases the public and private health expenditure, which improves the overall health status in developing host countries. This development together with technology spillovers from FDI allows people to have easier and smarter access to health services. (Chiappini et al., 2022, 7.) In developing host countries, foreign MNEs typically offer better social services than local firms (Nagel et al., 2015, 659). Additionally, FDI can also have a positive effect on host society's health by boosting the supply of health-related goods and services (Siddique et al., 2021, 84).

Despite multiple positive health benefits, the pollution risk associated with FDI creates serious health risks. In the manufacturing sector, especially in textile industry, FDI is known to cause pollution that is strongly associated with infant and child mortality. (Chiappini et al., 2022, 2.) For instance, in Malaysia the environmental degradation and carbon dioxide emissions are linked to MNEs

continuous growth in resource usage and pollution generation causing serious long-term harm to the environment, which directly threatens the population health (Hitam & Borhan, 2012, 333–339).

Unregulated FDI in developing countries can also lead to health hazards in the long run due to lack of policies and supervision (Siddique et al., 2021, 89–90). And in regions like Africa, the investors' actual contribution to collective social development, such as health services, is found to be often minimal (Fagbemi & Osinubi, 2020, 7). FDI's trait to increase wage inequality, makes it also harder for the poor people to invest in their own well-being, resulting in worse health conditions and lower life expectancy (Forte & Abreu, 2022, 12637).

Because FDI is generally viewed as a driver of economic growth and development in low-income countries, these countries seek to attract investments by creating a favourable environment for foreign investors. As a result, FDI can also influence the development of the host country via an indirect channel. A healthy workforce is considered one of the most important aspects attracting FDI because healthy workers are physically and mentally more robust, leading to higher productivity. Conversely, problems like infectious diseases or high death rates can deter FDI inflows because foreign investors fear for their own health and face increased production costs linked to health issues. (Alsan et al., 2006, 613–615.) By improving access to quality healthcare and enhancing population health, developing countries could attract higher FDI inflows (Immurana et al., 2023, 1).

4.2.2 Education effects: A path to development or an early exit?

FDI inflows to developing host countries create positive educational outcomes by increasing the demand for skilled labour and by relaxing public financial constraints (Wang & Zhuang, 2021, 3506–3507, 3510). FDI often introduces new technology and more modern managerial skills, and this stimulates the demand for highly skilled labour, creating individual motives for the local people to participate in higher education (Mughal & Vechiu, 2011, 3–5). FDI is able to indirectly increase the total amount of educated labour by adding to government tax revenues through expanded economic activity, which allows host countries' governments to increase their investments in the education sector (Kheng, Sun, & Anwar, 2017, 343–344).

Wang and Zhuang's (2021) regression model suggests a clear positive effect on both primary school enrolment and primary school completion rates for both genders. Model's panel data from 80 developing countries showed that a one-standard-deviation increase in FDI per capita leads to 6.65% increase in female primary school enrolment rate and 5.47% in male primary school enrolment rate. This positive impact is mainly due to the strong income effect, as adult family members are employed

in FDI, household incomes rise, leading naturally to an increase in household's investments in education as a standard part of economic growth. This income effect tends to overshadow the potential negative effects, like the opportunity cost of child labour or the need for children to perform household chores when their parents are more tied at work. (Wang & Zhuang, 2021, 3505–3520.)

MNEs tend to also have a noticeable and direct impact on higher education in developing countries (Blomström & Kokko, 2002, 16). Because the demand for highly trained graduates rises, MNEs typically show direct financial support towards higher education institutions, especially towards business schools and science facilities. MNEs also frequently support formal education through scholarships or participation in joint research projects with universities in the developing countries where their production plants or projects are located. (Miyamoto, 2003, 33.) MNEs provide attractive employment opportunities, which create motives for graduates especially in natural sciences, engineering, and business, to start and complete tertiary education (Blomström & Kokko, 2002, 16). Inward FDI's economic impact together with education effects can help developing countries also combat the "brain drain" phenomenon by creating jobs and expanding professional development opportunities locally (Kheng, Sun, & Anwar, 2017, 343–344).

While these potential positive effects are usually known to generate over long time periods, empirical research indicates a negative or insignificant relationship between FDI and secondary or tertiary education in the short run. When trade barriers fall, MNEs often seek efficiency in FDI to leverage the low-cost and low-skilled labour force available in developing countries. This is problematic, because it creates a strong incentive for young individuals to enter the labour market as early as possible, giving up higher education for immediate employment. As a result, FDI can negatively affect tertiary enrolment rates because the immediate availability of jobs and rising wages overrun the long-term motives for higher education. (Mughal & Vechiu, 2011, 11–16.)

Negative impacts of FDI on higher education have been found to hold substantial gender disparities. FDI is negatively affecting female enrolment rates much more than male enrolment rates, as FDI creates formal employment opportunities for women, which did not previously exist. This unfortunately reduces higher education participation among women. Also, in developing societies with limited household financial resources and strong old cultural preferences for sons, parents are more likely to withdraw daughters from educational institutions early rather than a son when seeking higher household income through possible MNE employment. (Wang & Zhuang, 2021, 3505–3529.)

As shown earlier, all FDI effects are conditional, and educational outcomes also depend heavily on the source of the investment and the characteristics of the host country and sector. FDI from countries

with higher levels of research and development (R&D), tends to generate larger technology spillovers that increase the demand for skilled labour and promote secondary and tertiary enrolment. Conversely, FDI from countries with lower economic development is more likely to have negative effect on higher education enrolments. Inward FDI in East Asia, the Pacific, and South Asia has been found to promote secondary and tertiary enrolments. This effect is linked to investment allocation towards the manufacturing and service sectors that require skilled labour. In contrast, in the Middle East, North Africa, and Sub-Saharan Africa, FDI is directed towards natural resources and mining sectors, which is known to have low job-creating potential, and typically fails to promote the technology transfers necessary for triggering positive educational enrolment effects. (Wang & Zhuang, 2021, 3523–3529.)

4.2.3 Inward FDI and poverty: Rising tide or widening gap?

Foreign direct investments are also recognised as crucial mechanisms in achieving significant global human development goals in poverty reduction and the financing of social safety nets (Chowdhury & Mavrotas, 2006, 10). Evidence shows that FDI can reduce poverty levels and improve overall human development, measured through indicators in education, life expectancy, and income (Forte & Abreu, 2022, 12632). In numerous developing countries, the correlation between FDI and poverty is clearly negative, meaning that foreign capital inflows successfully reduce the number of people living in poverty (Ucal, 2014, 1104). Recent research shows that a 1% increase in FDI inflows decreases the poverty rate by 1.32% on average in developing countries. For example the 1% increase in FDI reduces poverty by 0.9% in Latin America and by 0.15% in Asian developing countries. (Dhrifi et al., 2020, 17–19.) Notably, FDI has greater positive impact on poverty reduction in less developed and poorer developing countries than in the wealthier ones. While 0.15% might seem low, in Asian developing countries the poverty-reducing effect of FDI is considered particularly strong, and FDI inflows have directly improved welfare in history. (Ahmad et al., 2019, 22.)

However, FDI's true direct impacts on poverty and human development are mixed in developing host countries. In many developing countries, FDI fails to make a serious contribution to poverty reduction because the poorest segments of the population receive substantially much lower share of the income created by these foreign investments compared to the richest segments. In certain contexts, FDI actually actively increases the incomes of the richest groups while at the same time decreases the incomes of the poorer groups. (Sarisoy & Koc, 2012, 225, 237.) For example in Sub-Saharan African countries inward FDI have a direct negative effect on poverty reduction (Anetor et al., 2020, 1–2). In the long run, the overall effect of FDI on human capital and poverty in certain developing countries

can also remain entirely insignificant, as shown in case study of Nigeria (Fagbemi & Osinubi, 2020, 1). The FDI entry mode also plays role in the welfare effects, because for example, greenfield FDI brings significantly more welfare-changing benefits to the locals compared to M&As (Magombeyi & Odhiambo, 2017, 76-78). FDI also affects poverty in developing countries by altering the environmental quality of the host nations. Therefore, FDI's potential environmental damage is considered as a negative force that directly worsens poverty in developing countries. (Dhrifi et al., 2020, 14–18.)

5 Conclusions

In this thesis, the examination of inward FDI in developing countries revealed a landscape defined by deeply rooted contradictions, where the promise of the "Horn of Amalthea" (Bazile et al., 2024) collides with the harsh realities of structural vulnerability, social polarisation and the inevitable profit maximisation of MNEs. While the capital-centric views see FDI as a vital external catalyst capable of breaking vicious cycles of underdevelopment and poverty, this literature review suggests that the role is far more conditional and complex. This thesis sees FDI as a multifaceted developmental force, whose impact stretches far beyond mere capital flows.

The evidence on inward FDI's economic effects examined in this thesis is perhaps most eye-opening not for what it confirms, but for what it fails to confirm. At the microeconomic level, foreign-owned plants consistently outperform domestic firms in productivity, technological development and wages, and yet this firm-level dominance is not reliably translating into clear macroeconomic development. The knowledge spillovers are the mechanism most often believed to bridge this gap. But when the technological gap between foreign affiliates and local firms has grown too large, the spillovers fail to occur and MNEs operate in isolated enclaves disconnected from the surrounding developing host economy (Kokko, 1992, 163, 172). This pattern is extremely common across the less developed countries, where most inward FDI is directed towards natural resource extraction and the host countries rarely have the human capital or institutional qualities needed to absorb spillovers.

More importantly, the causality between FDI and economic growth in developing countries remains largely unclear. It is hard to solve if economic growth attracts FDI rather than the other way around, and if the significant policy efforts and financial incentives for MNEs that developing countries provide to attract FDI are more useless than expected. Also, the constant repatriation of profits by MNEs means that if FDI even contributes to GDP growth, it is unsure how much of that value truly reaches the host population (Iamsiraroj & Ulubaşoğlu, 2015, 202; Sumner, 2005, 272). However, it is important to acknowledge that if the host countries' conditions are favourable, inward FDI's economic effects on development are real and significant. In manufacturing and industrial sectors FDI has been shown to generate broad economic gains through employment creation, technology transfers and deep linkages with the local economy, and at the firm level, the productivity and wage premium that MNEs hold can elevate the developing host country's overall economic performance.

FDI's role in human development tells an equally complex story. In developing countries FDI does generate employment and raise wages, as doubling inward FDI per capita in a country such as

Ethiopia, for instance, has been found to reduce infant mortality rate by over four children per 1000 live births (Nagel et al., 2015, 663–664). MNEs also tend to invest in local education through scholarships and partnerships with universities. By increasing government tax revenues, FDI can also indirectly increase public investments on healthcare and education. While inward FDI does generate employment and raise wages, the gains unfortunately often flow unevenly to the already more skilled and educated labour force, potentially deepening the inequalities that development due to FDI is believed to reduce. The case study from Mozambique, where FDI drove aggregate growth without consistently reducing poverty, is not just an exception but rather a reflection of a broader pattern, what Bazile et al. (2024, 13–14) describes as social losses traded off for private gains.

One of the most interesting contradictions uncovered in this thesis concerns education. Inward FDI tends to raise household incomes and at the same time improve educational access, yet the same labour demand it creates simultaneously pulls young people out of school before they can build the skills needed to benefit from FDI in the long run. This trait creates a tension between the short-term employment need of many MNEs and the long-term human capital investments that genuine development requires. On the positive side, MNEs are usually found to maintain higher labour standards than their domestic counterparts, but unfortunately, for instance, FDI in the manufacturing sector has also been associated with increased environmental degradation in developing countries, raising concerns about the long-term population health and living conditions (Hitam & Borhan, 2012, 333–339).

This thesis concludes that inward FDI's role in developing countries is not to function as a reliable development catalyst, but rather as an amplifier of existing conditions. The broad review of FDI literature showed that where the institutions are strong, human capital is developed enough and linkages with the host economy are deep, FDI accelerates development. And where these foundations are too weak, FDI often reinforces structural vulnerabilities rather than resolving them. This leads to a central conclusion of this thesis: the countries that need development the most are those for whom FDI works the least reliably, because the preconditions required to capture its benefits are the same conditions that development is supposed to produce in the first place. Whether inward FDI is the "Horn of Amalthea" or just wishful thinking for developing countries, therefore is a matter of perspective and conditions. Although many developing countries differ from one another, in this thesis' broad context of developing countries, nearly every positive effect of inward FDI identified in both economic and human development was matched by a corresponding negative effect.

Since this thesis was conducted as a literature review, its content relies entirely on prior academic literature. It therefore may emphasise certain developing countries, that have received more research attention, along with outcomes and phenomena that occur more commonly in these countries. Asia, Latin America, and Sub-Saharan Africa, especially the larger African economies are more commonly emphasised in the literature, while in contrast, the Middle East, Oceania, North Africa, and smaller developing countries more generally received considerably less attention in the reviewed research.

Based on the findings of this thesis, their internal contradictions, and the broad review of current FDI literature, there is a clear need for further research in the future. In the context of inward FDI in developing countries, further research should be directed especially towards different sectors of the economy and towards comparative analysis of the effects of inward FDI across different entry modes. As this thesis has shown that greenfield investments and M&As tend to produce widely different outcomes, yet most of the empirical studies treat aggregate FDI as a uniform variable. Future research with a narrower geographic focus should be directed towards the least developed countries or other individual countries, as the effects of inward FDI are often most significant in these contexts. For example, a large greenfield project may play an extremely important role in the economic and human development of an entire underdeveloped region. Currently, most research focuses on FDI from developed to developing countries, but this pattern is gradually changing. And because of this, examining the effects of "South–South" FDI would also be highly relevant. Due to the long list of developmental drawbacks associated with inward FDI, continuous research on its effects remains valuable for developing countries, as they the power to influence which sectors, entry modes, and source countries they target when attracting FDI. Research on this topic may also provide insightful information for MNEs that seek to take responsibility in understanding their true impact on host economies. Above all, the significant and contradictory findings of this thesis further demonstrate, as noted in the beginning, that research on the effects of inward FDI carries profound ethical and human weight.

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Appendices

Appendix 1 Use of artificial intelligence tools

Generative AI tools were used in support of writing this bachelor's thesis. The tools used, their purpose, and the methods are specified in the examples below. I confirm that I have used AI in an appropriate manner and reported its use in accordance with the university's policies.

AI tool: OpenAI ChatGPT (model: 5.1)

- Usage phase: Planning and scoping the thesis topic
    - Purpose of use: I used ChatGPT as support in brainstorming and narrowing down the research topic.
        - Example prompt (17.1.2026): I would like to write my bachelor's thesis on the effects of FDI on the host country. What kinds of effects could I cover?
        - Example prompt (19.1.2026): If I were to write about the impact of FDI on development, how should I narrow down the thesis? Would it be worth focusing on a specific country, region, or demographic group?
    - Utilising the responses: ChatGPT introduced me to various topics that I could address in the thesis, such as spillover effects. ChatGPT also suggested different ways to scope the research, such as comparing different entry modes. Together with ChatGPT, I refined my topic further and settled on the perspective of economic and human development in developing countries
- Usage phase: Structuring the thesis and the table of contents
    - Purpose of use: I discussed with ChatGPT the topics I had found in the literature, such as the effects of FDI on productivity and employment. We discussed the order in which the different topics should be addressed, and how to structure the table of contents.
        - Example prompt (15.2.2026): Would it be possible to divide the economic effects into microeconomic and macroeconomic effects?

        - Example prompt (16.3.2026): Where in the thesis would it be best to place the section on income level and distribution, in order to keep the key sections balanced? Does crowding effects fit under macroeconomic effects?
        - Utilising the responses: ChatGPT assisted in structuring the thesis, and for example supported the division into macro- and microeconomic effects. It also helped in drafting the table of contents and confirmed my ideas about where each topic would best be placed.

- Usage phase: Searching for literature
    - Purpose of use: I used ChatGPT to help to come up with search terms and phrases that I could use to find reliable scientific sources related to my thesis' topic.
        - Example prompt (25.1.2026): "I am writing a bachelor's thesis on FDI's effects on the economic and human development in developing countries. What search terms could I use to find good scientific sources on the topic?
        - Example prompt (28.2.2026): What search terms could I use to search Google Scholar or UTU Volter for information on spillover effects caused by FDI in developing countries?
            - Utilising the responses: The AI suggested terms such as "FDI knowledge spillovers" and "backward linkages FDI" and search combinations such as "FDI spillovers" AND "developing countries" AND productivity and "foreign direct investment" AND "economic growth" AND "developing countries". I used the search terms suggested by ChatGPT and found useful literature, but all sources were selected and read by me at the end.

- Usage phase: Translation assistance
    - Purpose of use: I asked ChatGPT to translate some sentences from my sources into Finnish to ensure that I understood the content accurately and comprehensively.

        - Example prompt (25.2.2026): Translate this sentence into Finnish: “However, a higher growth promoting influence is found for manufacturing-FDI with a coefficient value of 0.642, revealing the manufacturing sector’s higher linkages and spillovers potential from FDI inflows for the host country .”
            - Utilising the responses: I verified from the AI's translations that I understood what I had read and was able to cite my sources correctly.

AI tool: Claude (model: Sonnet 4.6)

- Usage phase: Synonyms and alternative phrasing
    - Purpose of use: I used Claude to search for synonyms for terms and verbs I wanted to use in my text. I also asked Claude to suggest alternative expressions for some of my sentences.
        - Example prompt (28.3.2026): Could you give me synonyms for the words 'reinforce' and 'financial constraints'?
        - Example prompt (4.4.2026): Could you help me rephrase my sentence in a way it is easier to understand: “Market limitations can also cap total production levels, and, if firms enhance higher productivity, they might reduce their staff to avoid overproduction and excess inventory.”
            - Utilising the responses: I used the synonyms provided by Claude to phrase my sentences as clearly as possible, and to avoid the repetition of the same verbs weakening the flow of the text. Claude suggested synonyms such as 'deepen' and 'credit limitations'. For some sentences or shorter expressions, Claude suggested for example splitting a sentence into two or rephrasing it more simply. The AI only provided suggestions, and all sentences in the thesis in their final form were written by me.
- Usage phase: Language checking
    - Purpose of use: I used Claude to check the correctness and clarity of my language.

        - Example prompt (13.4.2026): Are there any spelling mistakes or clearly incorrect terms in these sentences: “Because FDI is generally viewed as a driver of economic growth and development in low-income countries, these countries seek to attract investments by creating a favourable environment for foreign investors. As a result, FDI can also influence the development of the host country via an indirect channel. And healthy workforce is considered one of the most important aspects attracting FDI because healthy workers are physically and mentally more robust, leading to higher productivity.”
        - Example prompt (15.4.2026): Are these sentences clear and easy to understand: “A primary source of controversy is the allegation that these MNEs take advantage of workers by making them work in so-called “sweatshop" conditions, which are defined by low wages and workspaces that are abusive, unhealthy, and unsafe (Brown, Deardorff, & Stern, 2004, 269). Critics claim that the mobility of international capital creates a "race to the bottom" for MNEs. This “race” encourages these companies to increase their profit margins strategic changes, such as lowering wages, eliminating social protections, and lowering workplace standards. (Epstein, 2019, 165.)”
            - Utilising the responses: Claude helped me notice spelling mistakes or weak terms in my text. And if I was uncertain about my sentences, it confirmed whether they were clear or whether they still needed further consideration.

- Usage phase: Brainstorming title alternatives
    - Purpose of use: I used Claude in reflecting the suitability and informativeness of the title and the headings.
        - Example prompt (10.4.2026): Does the title of my thesis match its table of contents? Is the term "sweatshop" appropriate for use in an academic thesis?
            - Utilising the responses: In its responses, Claude may have confirmed that the headings were appropriate, or for instance suggested considering whether they could be refined in some other way.