Modeling FDI Flows from the USA to Canada: Two Main International Financial Variables Affect the Long-Run Economic Growth

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Abstract

This paper develops a model to predict for the spillover effects of the foreign capital inflows on the long run growth under conditions of international economic exposure to foreign exchange rate fluctuations. The paper utilizes a simple open economy version of the Solow growth model with the main features of real business cycle models. In addition, the paper uses a time series model with substitution techniques to test the impact of the spillover effect of foreign capital inflows from the USA on long run growth in Canada, while controlling for exposure to foreign exchange rate fluctuations, as well as for both external and internal balances. The results support the existence of positive spillover effects from foreign direct investment on the economy. The results also show that foreign exchange rate fluctuations have weaken the impact of underlying changes in productivity on the attractiveness of the economy to overseas investors and hence moderate the overall impact of the technology spillover effect of Foreign Direct Investment (FDI) on long-run growth.

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