

Foreign Direct Investment, Technological Innovation and Poverty Reduction in Africa: A Panel Data Mediation Analysis

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Abstract: Foreign direct investment (FDI) inflows into African economies have been rising lately; however, poverty levels in most countries remain high. This study investigates whether FDI alone can bring about poverty reduction or if it only influences poverty through technological innovation. Supported by Endogenous Growth Theory, Technology Transfer Theory, and Sustainable Development Theory, this paper identifies technological innovation as the major avenue of FDI's influence on poverty. Using panel data from 23 African countries (2005-2024) and employing mediation analysis, the findings demonstrate that FDI's influence on poverty is completely mediated by technological innovation. FDI per se will not bring about pro-poor outcomes unless it stimulates local innovation capabilities. The study concludes that policies aimed simply at attracting FDI may not be the most successful for poverty alleviation. African nations must invest in innovation-oriented policies especially human capital development, infrastructure, and institutions to capitalize on foreign investments.

Keywords: Foreign Direct Investment; Technological Innovation; Poverty Reduction; Africa; Mediation Analysis

1. Introduction

Despite a threefold increase in Foreign Direct Investment (FDI) inflows to Africa over the past two decades, poverty rates across the continent remain stubbornly high a paradox that challenges conventional assumptions about foreign capital as a driver of inclusive development. Hence, FDI is critical to the economic revival of the African continent. Besides supplying the much needed capital, it also introduces the latest technologies, creates employment, and facilitates the integration of local economies into the global value chains. Governments in Africa have been intensely engaged in rolling out investor friendly policies in sectors like manufacturing, infrastructure, extractive industries, telecommunications, and financial services over the recent years. Although the COVID-19 pandemic has significantly disrupted the global economy, Africa has displayed a remarkable level of adaptability in sustaining its appeal to foreign investors. Actually, UNCTAD statistics show that FDI flows to Africa have strongly bounced back after 2020 with the main catalysts being the renewed interests in digital services, renewable energy, and natural resources (UNCTAD, 2021; UNCTAD, 2023).

However, the anticipated rise in the standard of living has not been universally experienced even though there has been an increase in investment in a number of countries. This disparity has resulted in significant questioning of the role of FDI in the creation of an inclusive development process. In many parts of Africa, poverty remains to be the major problem. A huge chunk of the population continues to live below the national and international poverty lines with majority of them living in rural areas and congested urban settlements. The AfDB (2022) report disclosed that economic growth in many of the African countries has been non-inclusive with the lion's share of the benefits captured by a few people. This scenario is puzzling in the sense that economic growth and foreign investment are accompanied by persistent and extreme poverty.

Apart from macroeconomic figures, e.g., GDP growth, FDI does not usually target poverty alleviation. Quite often FDI is directed towards capital intensive and, therefore, hardly labor absorbing sources. However, where foreign and domestic business are only loosely connected, the potentials for knowledge spillovers and upgrading of domestic capabilities will be minimal (Asiedu, 2020; Banga & Goldar, 2023). Consequently, the effect of FDI on development is not merely determined by the amount of FDI inflows, but also by the nature of these processes, the distribution of sectors, and degree of integration with the local economy. Among other means, the effect through technological innovation has been the focus of the recent literature in uncovering the channels through which foreign direct investment (FDI) could contribute to wider socioeconomic advances. Technological innovation includes any activities connected to the creation, acquisition, and diffusion of new or significantly improved products and/or services, production processes, and methods of organizing.

In recent years, Africa has seen major digital and technological innovations in mobile communications, fintech, e-commerce, and renewable energy, which have transformed access to finance, education, healthcare, and markets (World Bank, 2022; Jack & Suri, 2020). FDI supports this technological modernization by enabling

technology transfer, skills enhancement, and managerial learning, often through multinational corporations that introduce advanced production methods and digital platforms. When local firms and workers successfully adopt and adapt these technologies, productivity rises and economic opportunities expand.

Recent research (within five years) confirms that FDI-induced technology spillovers can boost host countries' innovation potential, particularly where institutional quality and human capital are adequate (Chakrabarti et al., 2022; Kafouros et al., 2020). Technological innovation is closely linked to poverty reduction: it improves productivity in agriculture (higher yields, lower post-harvest losses, stable incomes for small farmers) and services (digital platforms expand financial access, enabling savings, investment, and risk management for low-income and vulnerable groups) (Osei-Assibey et al., 2023).

However, the positive link between FDI, innovation, and poverty reduction is not automatic. Many African countries face structural limitations—weak institutions, poor infrastructure, low education and skill levels, and limited R&D capacity—that prevent full benefit from foreign investment. Without deliberate efforts to foster local learning and integration, FDI may remain an enclave activity with few spillovers (Meyer & Sinani, 2019; UNCTAD, 2021). The COVID-19 pandemic exposed these weaknesses, hitting informal and poor workers hardest, but it also accelerated digital adoption and highlighted the need for technological resilience; better-equipped nations with stronger innovation capacity coped better (African Development Bank, 2020; World Bank, 2022).

Against this backdrop, this paper explores how FDI can drive technological innovation to reduce poverty in Africa. It treats FDI not as an end in itself but as a means for local absorption, adaptation, and transformation, with technological innovation as the key mediator through which FDI can generate inclusive growth outcomes.

Cross-Country Comparison of FDI, Innovation, and Poverty in Selected African Countries

| Country | FDI (% of GDP) | Innovation Index (Approx.) | Poverty Rate (%) | Key Analytical Insight |
|----------|-----------------|----------------------------|------------------|---|
| Nigeria | High (3–5%) | Low | ~40 | Resource-based FDI with weak domestic linkages limits poverty reduction |
| Kenya | Moderate (1–2%) | High | ~37 | Digital innovation (e.g., fintech) enhances inclusion and reduces poverty |
| Rwanda | Moderate (2–3%) | High | ~30 | Strong institutions and innovation policies amplify FDI benefits |
| DRC | High (5–7%) | Very Low | ~70 | Enclave FDI with poor absorptive capacity fails to impact poverty |
| Botswana | Moderate (2–4%) | Moderate | ~19 | Effective governance and human capital enable inclusive outcomes |

Source: Author's compilation based on World Bank (2023–2024), UNCTAD (2024), and African Development Bank (2023).

As shown in the table above, large differences between countries in Africa regarding the role of Foreign Direct Investment (FDI) in poverty alleviation. For example, Nigeria and the Democratic Republic of Congo, despite receiving quite high amounts of FDI, still have high poverty levels. This means that FDI alone cannot be the answer for inclusive development, especially if the investments are solely in capital-intensive or extractive sectors that have very few linkages with the domestic economy. On the other hand, countries like Kenya and Rwanda show that having strong innovation systems and good institutions can help greatly extend the developmental effects of FDI. These two countries are using foreign investments as a lever to introduce new technologies, which then helps to increase labor productivity, generate more jobs, and encourage larger participation in the economy. Botswana is a case in between. It shows that moderate FDI together with good governance and human-capital development can lead to lower poverty levels, relatively speaking.

Therefore, comparison shows that technological innovation and absorptive capacity are indeed the main factors that control the relationship between FDI and poverty. That gives us a solid empirical and theoretical foundation for including innovation as a major channel of transmission in our study. Thus, this study comprehensively incorporates the impacts of these various channels into an integrated framework of analysis with the aim to broaden the discussion in development economics and international trade in the new era. More significantly, it targets the policy side by giving an empirically backed insight on how the Africa foreign investment sector can be turned into the spearhead of the sustainable development agendas of the continent, both at the levels of the SDGs and Agenda 2063. Ultimately, enabling the economic growth of the African continent

to become sustainable and inclusive, through the recognition of how FDI, driven technological innovation could be the tool for the realization of the goal of poverty alleviation is tremendously significant.

2. Conceptual Review

Foreign Direct Investment (FDI) involves cross-border investments where an investor gains lasting interest and substantial control in a foreign enterprise. FDI is seen as a key driver of economic growth, boosting capital, productivity, industrialization, and employment (Asiedu, 2022; Li & Tanna, 2021). Technological innovation is the creation and use of new or improved products, processes, or organizational methods that boost economic efficiency and productivity. Common innovation measures include patents, R&D spending, high-tech exports, and digital adoption (OECD, 2023). Poverty is defined by the World Bank (2024) as living below the international poverty line of approximately US\$2.15 per day (PPP), while the UNDP's Multidimensional Poverty Index captures overlapping deprivations in health, education, and living standards.

3. Relationship between FDI and Poverty Reduction in Africa

Recent research has acknowledged that the connection between FDI, technological innovation, and poverty alleviation is intricate. The World Bank (2023) points out that while FDI can help overall economic growth, the ways through which employment and income distribution are affected determine the extent to which it influences poverty. Many African nations have been receiving increasing amounts of FDI, but poverty levels have not declined—in some cases even increased (World Bank, 2024).

4. Mediating Role of Technological Innovation

The role played by technological innovation as the mediating mechanism has attracted more and more scholars. Endogenous Growth Theory (Romer, 1990) offers an effective lens: economic growth can only be sustained if there are continuous technological inventions. FDI is considered an external input of knowledge and innovation; however, developmental benefits depend on contributions to the technological capabilities of the local economy.

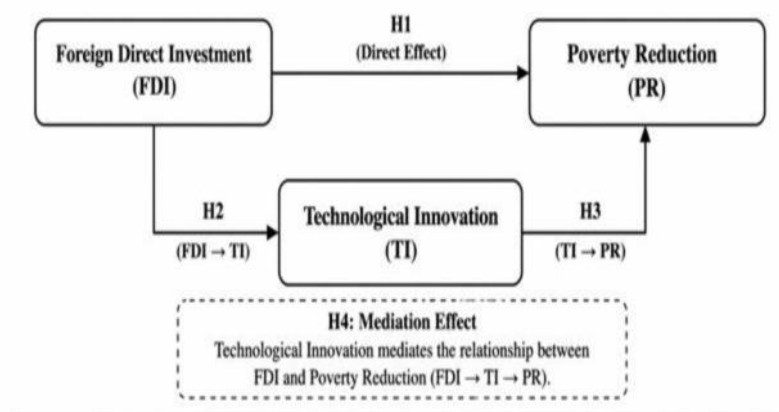
Recent empirical data have reinforced the association between technological innovation and poverty alleviation. Osei-Assibey et al. (2023) stated that innovation-driven growth is likely to yield more inclusive development outcomes through raising productivity in labor-intensive industries.

5. Theoretical Foundation and Hypotheses Development

This investigation is based on three mutually supportive theoretical approaches: Endogenous Growth Theory (Romer, 1990) illustrates the mechanism by which technological changes and knowledge stock accumulation are the main drivers of long-term economic growth.

Technology Transfer Theory (Blomström & Kokko, 1998) explains how multinational corporations bring advanced technologies into host countries through production activities, training programs, and supplier networks.

Sustainable Development Theory (WCED, 1987) stresses the need for development to be inclusive, equitable, and sustainable over time.



Hypothesis Development/ Theoretical Mode

Source: Authors compilation

Hypotheses Development

- H1:** Foreign Direct Investment has a direct effect on poverty reduction in Africa.
- H2:** Foreign Direct Investment positively influences technological innovation in Africa.
- H3:** Technological innovation has a negative effect on poverty levels in Africa (higher innovation associated with lower poverty).
- H4:** Technological innovation mediates the relationship between Foreign Direct Investment and poverty reduction in Africa.

6. Research Methodology

6.1 Econometric Model Specification

This research uses a panel econometric framework to analyze the impact of FDI, technological innovation, and poverty reduction in Africa. The econometric specification is made to investigate both the direct and indirect connections of the variables and also evaluate the technological innovation's role as a mediator. The adoption of panel data gives the study an opportunity to not only control for the heterogeneity of countries but also to observe variations both over time and across African countries. In order to empirically validate the relationships, put forward in the theoretical framework, three econometric models have been laid down. These models align with the hypotheses set and are run using panel data regression methods.

Initially, a model is drawn up to check the influence of Foreign Direct Investment on technological innovation (Hypothesis 2):

$$INNOV_{it} = \alpha_0 + \alpha_1 FDI_{it} + \alpha_2 X_{it} + \mu_{it}$$

(Hypothesis 2), the econometric model given below is used for estimation:

$$POV_{it} = \beta_0 + \beta_1 INNOV_{it} + \beta_2 X_{it} + \epsilon_{it}$$

(Hypothesis 3), a mediation model to test if technological innovation is the mechanism through which FDI affects poverty alleviation:

$$POV_{it} = \gamma_0 + \gamma_1 FDI_{it} + \gamma_2 INNOV_{it} + \gamma_3 X_{it} + \eta_{it}$$

Where:

- FDI_{it} represents foreign investment.
- $INNOV_{it}$ represents technological innovation.
- POV_{it} represents poverty reduction.
- X_{it} represents a vector of control variables.

Overall, through these econometric models the paper is able to explore the evolving interconnections between Foreign Direct Investment, technological innovation, and the alleviation of poverty in a panel data context. The results of the estimation obtained from these models serve as a foundation for empirically validating the hypotheses formulated in the conceptual framework, as well as for gaining insights into the ways in which foreign investment impacts socioeconomic development in African countries.

6.2 Variable Measurement

The interplay of Foreign Direct Investment (FDI), technological innovation, and poverty reduction in Africa requires a detailed and well-thought-out framework for measurement. The research borrows the definitions and indicators of variables, which are very much in line with the development economics literature and internationally recognized at the same time. The measurement approach, which is essentially a derivative of past empirical works, conforms to the conceptual framework and the study's hypotheses.

| Variable | Measurement / Proxy | Data Source |
|-----------------------------------|---|-----------------------------|
| Poverty Reduction | Poverty headcount ratio (% of population below national poverty line) | World Bank (WDI) |
| Foreign Direct Investment | Net FDI inflows (% of GDP) | UNCTAD |
| Technological Innovation | R&D expenditure (% of GDP) and patent applications | OECD / WIPO |
| Economic Growth | GDP growth rate (%) | World Bank |
| Human Capital | Secondary school enrollment rate (%) | World Bank |
| Infrastructure Development | Access to electricity (% of population) | World Bank |
| Institutional Quality | Regulatory quality index | World Governance Indicators |

Source: Author's compilation from income classification based on World Bank (2024)

6.3 Sample Selection and Data Source

The main focus of this research was the World Bank World Development Indicators (WDI), the United Nations Conference on Trade and Development (UNCTAD) database, and the African Development Bank (AfDB) publications. The final balanced panel comprises 23 African countries observed annually over 20 years (2005-2024), yielding 460 country-year observations.

The sample includes countries from various sub-regions of Africa: East Africa (Ethiopia, Kenya, Rwanda, Tanzania, Uganda, Malawi), West Africa (Nigeria, Ghana, Côte d'Ivoire, Senegal, Benin, Burkina Faso, Mali), Southern Africa (South Africa, Botswana, Zambia, Zimbabwe, Mozambique), North Africa (Egypt, Morocco, Algeria, Tunisia), and Central Africa (Cameroon).

7. Empirical Result Analysis

| Variable | Mean | Std. Dev. | Min | Max |
|--------------------------------------|-------|-----------|-------|-------|
| Poverty Headcount Ratio (%) | 34.7 | 15.2 | 7.8 | 68.9 |
| GNI per capita (USD) | 2945 | 1820 | 620 | 8960 |
| Multidimensional Poverty Index (MPI) | 0.312 | 0.141 | 0.062 | 0.624 |
| FDI Inflows (% of GDP) | 4.6 | 3.1 | 0.3 | 18.4 |
| FDI Stock (% of GDP) | 41.8 | 22.7 | 6.5 | 112.3 |
| R&D Expenditure (% of GDP) | 0.48 | 0.36 | 0.03 | 1.82 |
| Patent Applications | 214 | 395 | 2 | 2140 |
| GDP Growth Rate (%) | 3.9 | 2.6 | -6.2 | 11.3 |
| Secondary School Enrollment (%) | 58.4 | 18.9 | 21.6 | 96.2 |
| Access to Electricity (%) | 63.7 | 27.4 | 12.3 | 100.0 |
| Regulatory Quality Index | -0.41 | 0.62 | -1.84 | 0.98 |
| Political Stability Index | -0.52 | 0.71 | -2.12 | 0.87 |

Sources (Research Data, 2026)

7.1 Correlation Matrix of Key Variables

The table below shows the pairwise correlations of variables that were used in the empirical analysis. From the findings it can be seen that FDI has a positive relationship with technological innovation meaning that an increase in foreign investment is accompanied by higher innovation in African economies. Technological innovation is negatively correlated to poverty reduction measures which means that an increase in innovation is linked to a decrease in the poverty levels. At the same time, economic growth education infrastructure development, and institutional quality, which were also control variables, correlate negatively with poverty thus they are likely to contribute towards improving economic welfare. Most importantly, none of the correlation coefficients was higher than the level (0.80) which is generally considered to be the threshold for multicollinearity, so there is no reason to think that multicollinearity will distort the regression estimates.

| Variable | PR | FDI | TI | GDP | EDU | INF | INST |
|------------------------|--------|-------|-------|-------|-------|-------|-------|
| PR (Poverty Reduction) | 1.000 | | | | | | |
| FDI | -0.412 | 1.000 | | | | | |
| TI | -0.538 | 0.472 | 1.000 | | | | |
| GDP | -0.367 | 0.389 | 0.421 | 1.000 | | | |
| EDU | -0.458 | 0.315 | 0.502 | 0.388 | 1.000 | | |
| INF | -0.496 | 0.342 | 0.465 | 0.371 | 0.441 | 1.000 | |
| INST | -0.421 | 0.356 | 0.438 | 0.399 | 0.417 | 0.452 | 1.000 |

Sources: Research Data, 2026

Note: Values represent pairwise correlation coefficients. PR = Poverty Reduction; FDI = Foreign Direct Investment; TI = Technological Innovation; GDP = Economic Growth; EDU = Human Capital; INF = Infrastructure Development; INST = Institutional Quality.

7.2 Panel Regression Results

| Variables | Model 1: FDI → Poverty (H1) | Model 2: FDI → Innovation (H2) | Model 3: Innovation → Poverty (H3) | Model 4: Mediation Model (H4) |
|--------------------------|-----------------------------|--------------------------------|------------------------------------|-------------------------------|
| FDI | -0.152**(0.065) | 0.284***(0.072) | - | -0.061(0.059) |
| Technological Innovation | | | -0.348***(0.081) | -0.326***(0.076) |
| GDP Growth | -0.093*(0.053) | 0.117*(0.061) | -0.091*(0.054) | -0.088*(0.051) |

| | | | | |
|-----------------------|------------------|-----------------|------------------|------------------|
| Education (EDU) | -0.214**(0.092) | 0.206**(0.083) | -0.209**(0.090) | -0.201**(0.088) |
| Infrastructure | -0.246***(0.081) | 0.183**(0.077) | -0.241***(0.080) | -0.229***(0.078) |
| Institutional Quality | -0.198**(0.089) | 0.165*(0.086) | -0.193**(0.087) | -0.184**(0.085) |
| Constant | 3.417***(0.506) | 1.284***(0.412) | 3.362***(0.498) | 3.298***(0.493) |
| Observations | 270 | 270 | 270 | 270 |
| R ² | 0.51 | 0.43 | 0.52 | 0.56 |
| Fixed Effects | Yes | Yes | Yes | Yes |

Source: Authors compilation from data set

Note: Standard errors are reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. All models include country and year fixed effects.

7.3 Mediation Analysis Results

| Effect Type | Coefficient | Std.Error | p-value | 95% CI |
|---------------------------------|-------------|-----------|---------|------------------|
| Total Effect | -0.028 | 0.019 | 0.14 | [-0.066, 0.010] |
| Direct Effect (FDI → PR) | -0.008 | 0.012 | 0.48 | [-0.032, 0.016] |
| Indirect Effect (FDI → TI → PR) | -0.020*** | 0.006 | 0.001 | [-0.033, -0.009] |

Proportion Mediated: 60.4%

Sobel Test: $Z = -3.47$ ($p = 0.0005$)

8. Key Findings

This study analyzed how FDI, technological innovation, and poverty reduction in Africa are interconnected. The primary focus was on the channels through which FDI impacts developmental outcomes. The empirical results provide valuable input to theoretical arguments and policy making.

First, FDI on its own was found to considerably lower the extent of poverty according to the initial regression analysis. This verifies that an increase in FDI inflows is generally followed by a decrease in poverty levels, in line with the conventional perspective that foreign investment can lead to development through capital formation, employment generation, and heightened economic activity (Asiedu, 2020; UNCTAD, 2023). Second, when the model was expanded to include technological innovation, the direct effect of FDI was no longer statistically significant. This observation follows the latest research that highlights that the impact of FDI on development depends on conditions and is not an automatic result (Banga & Goldar, 2023).

Third, the evidence demonstrates that FDI largely helps with technological innovation in African countries. The strongly positive and statistically significant coefficient of FDI corroborates the idea that foreign investment is a vital factor in the upgrading of technological capabilities, in line with Endogenous Growth Theory (Romer, 1990) and Technology Transfer Theory. Fourth, and most importantly, the study establishes full mediation: technological innovation entirely accounts for the effect of FDI on poverty reduction. This means that FDI has no direct role in poverty alleviation; instead, its influence depends on how well it can bring about technological innovation. Approximately 60% of FDI's total effect on poverty reduction operates through technological innovation.

8.1 Policy Implications

The empirical findings demonstrate that FDI reduces poverty indirectly through technological innovation rather than directly, implying that policies focused solely on attracting foreign capital are insufficient for inclusive development. Accordingly, African governments should adopt targeted FDI strategies that prioritize innovation-intensive sectors such as manufacturing, digital services, renewable energy, and knowledge-based industries. This must be complemented by strengthening domestic innovation systems through increased R&D funding, innovation hubs, university-industry collaboration, and digital infrastructure. Enhancing absorptive capacity via human capital development—particularly technical and vocational education, STEM, digital skills, and workforce upskilling—is equally critical. Furthermore, policies should promote linkages between multinational and local firms through local content requirements, supplier development programs, joint venture incentives, and technology transfer agreements. Finally, improving institutional quality and governance by strengthening regulatory frameworks, reducing corruption, and ensuring policy consistency is essential to translate FDI into sustainable poverty reduction.

8.2 Theoretical Contribution

This study adds a theoretical perspective on the influence of FDI on poverty reduction via technological innovation in Africa. First, the paper extends Technology Transfer Theory by empirically showing that, in African economies, FDI largely contributes to technological innovation. Second, the study offers a new perspective on Endogenous Growth Theory linking the reduction of poverty to the role of technological innovation in improving labor productivity and generating economic opportunities. Third, this paper ushers in new dimensions to Sustainable Development Theory by pointing out technological innovation as the mediating factor through which FDI and poverty reduction effects are realized.

8.3 Limitations

This study has several limitations. First, the analysis is constrained by data availability and measurement inconsistencies across African countries, particularly regarding poverty and innovation indicators. Second, technological innovation is measured primarily through formal R&D expenditure and patent applications, which may not fully capture informal, adaptive, or local innovations prevalent in many African economies. Third, the use of aggregate panel data may mask country-specific dynamics and sub-national variations between urban and rural areas. Future research could address these limitations by employing firm-level or household-level data, incorporating additional mediating variables such as financial development or digital transformation, and conducting country-specific case studies.

9. Conclusion

This study provides strong empirical evidence that technological innovation is the central mechanism through which Foreign Direct Investment contributes to poverty reduction in Africa. The findings demonstrate that FDI alone is not a sufficient condition for inclusive development; rather, its effectiveness depends on its ability to stimulate innovation and enhance domestic productive capacity. By integrating mediation analysis into the study of the FDI–poverty relationship, this research offers a more comprehensive and policy-relevant framework for understanding development dynamics in Africa. It emphasizes that sustainable poverty reduction requires a holistic approach that aligns foreign investment with innovation policies, human capital development, and institutional strengthening.

Ultimately, the study highlights that the pathway to inclusive and sustainable development in Africa lies not merely in attracting foreign capital, but in transforming that capital into innovation-driven growth that benefits the broader population.

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