

Does the Gravity Model Work as Regards FDI?

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FDI is thought to be one of the contemporary most dynamic factors of internationalization in both micro (companies) and macro (economies) scales. The gravitation model is widely applied in social sciences, therefore it is worth verifying whether it is able to cope with FDI development. The cognitive purpose of the paper is to explore a capability for explaining the FDI opportunities within the EU countries by the gravity model, which covers the size of the given economies and the distance between them. The innovative approach to the research is interpreting the size of economies as measured by total exports and imports flows, instead of the traditional GDP method. The empirical analysis is based on the gravity model estimation for panel data of selected EU countries from 2004 to 2010. The selection of the period of the study was due to the availability of OECD International Direct Investment Statistics. 282 bilateral relationships between countries were considered, giving 1889 observations. The conclusion is that the gravity model of FDI works for both considered measures of the size of economy – the total trade and GDP. Therefore the trade is stimulating FDI flows (stocks) over the examined period.

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