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# Foreign direct investment and its impact on economic growth in Papua New Guinea: A theoretical perspective

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**Abstract**

This theoretical paper examines the impact of Foreign Direct Investment (FDI) and economic prosperity in Papua New Guinea. The study analyses the influence and correlation of FDI inflows on the growth of the national economy, using GDP growth as a proxy for economic well-being, applying regression and correlation analysis based on time-series from 2002 to 2022. Findings indicate a statistically insignificant correlation between the growth rate of FDI and GDP, suggesting that external investments alone do not directly influence economic growth. The study attributes this weak linkage to the concentration of FDI in mining and extractive sectors, which typically have limited employment and value chain effects. The contribution of the paper lies in offering sector-specific policy recommendations to diversify FDI into manufacturing, agriculture, and the service industry to contribute to economic growth. It recommends infrastructure development, policy stability, and human development to increase the economic return of foreign investments. This theoretical paper contributes to the literature by confirming that FDI's effectiveness in promoting economic growth is context-dependent and requires strong absorptive capacities in the host economy.

**Keywords:** Foreign direct investment, economic growth, Papua New Guinea, extractive industries

## 1. Introduction

Foreign Direct Investment (FDI) has long been viewed as an inducement for economic development, especially in emerging economies. It brings with it not just capital but also advanced technology, managerial expertise, and potential spillover effects that can enhance domestic productivity (Borensztein, De Gregorio, & Lee, 1998). In theory, FDI contributes positively to

Gross Domestic Product (GDP) by increasing capital formation, employment, and export capacity. However, empirical findings have varied significantly across regions, pointing to the fact that the growth impact of FDI is highly context-dependent (Alfaro et al., 2004; UNCTAD, 2020).

In PNG, a resource-rich Pacific nation, FDI has largely been concentrated in the extractive sectors such as mining, oil, and gas. While these sectors attract large-scale investments, their contribution to inclusive economic growth remains uncertain due to limited employment generation and weak linkages with the broader economy & value addition (World Bank, 2020). This study explores the theoretical relationship between FDI and GDP growth in PNG over the period 2002–2022. By applying regression and correlation analysis on time-series data, the paper assesses whether rising FDI inflows have translated into improved economic performance. The paper presupposes that FDI should align with national development objectives and be embedded in a robust strategic framework to yield long-term benefits.

## 1.1 Background

Papua New Guinea, endowed with abundant natural resources, has traditionally relied on extractive industries to drive economic activity. The country's FDI profile reflects this pattern that 80% of foreign capital has historically targeted large-scale mining, oil, and gas projects, such as the PNG LNG project (ADB, 2021). While such projects contribute significantly to export earnings and fiscal revenues, they typically generate limited employment due to their capital-intensive nature & lack of value addition (IMF, 2022). Furthermore, local content development like industrial development, employment growth, and skill upgrading remains minimal, with few input-output linkages to the rest of the economy (World Bank, 2020).

The effectiveness of FDI in promoting growth is heavily influenced by the integration potential of the host economy, a concept that includes infrastructure readiness, human resource development, institutional quality, and macroeconomic stability (Blomström & Kokko, 2003). In PNG, however, several constraints hinder the productive utilization of foreign investments. These include:

- weak infrastructure: poor transportation and power infrastructure increase the cost of doing business, reducing the multiplier effect of FDI on local firms (ADB, 2021).
- limited manpower: low educational attainment and skill mismatches limit local participation in FDI-led projects (UNDP, 2021).
- lack of value addition in the extractive and agriculture sectors.

This theoretical concern is empirically reinforced when we observe trends in FDI inflows and GDP growth in PNG over the past two decades.

As shown in Figure 1, FDI inflows have generally increased over the 2002–2022 period, particularly after 2010. However, GDP growth has not followed the same upward trajectory; instead, it remains relatively volatile and modest (World Bank, 2020). A texture finding of this study supports this discrepancy, that the correlation between FDI and GDP growth is statistically weak in the case of PNG. The disconnect can be attributed to the extractive nature of most FDI, which tends to bypass domestic labor markets and value chains. Hence, for FDI to function as a genuine engine of development, PNG must diversify its FDI portfolio into sectors with stronger employment and productivity spillovers.

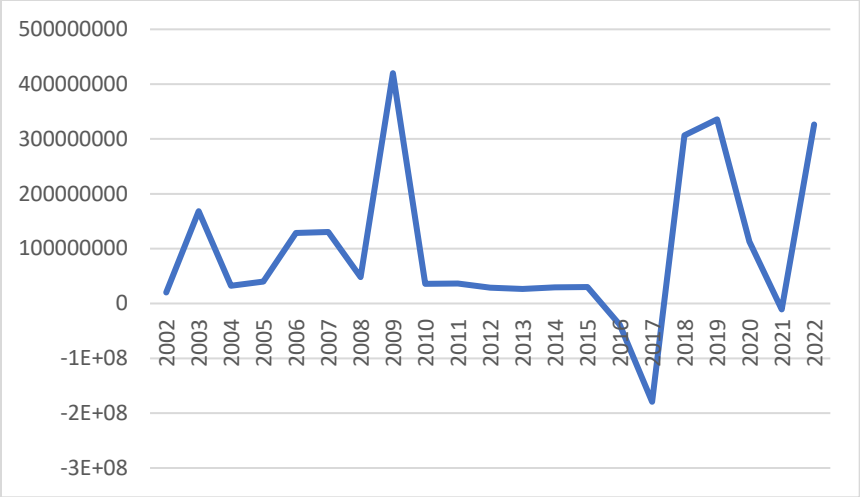


Figure 1: FDI Inflows and GDP Growth in Papua New Guinea
Source: Literature survey

### 1.2 Research objectives

- To assess the correlation between FDI inflows and GDP growth rate in PNG
- To evaluate the economic and structural variables influencing FDI's influence on PNG's economic development
- Considering the findings, offer recommendations to key stakeholders.

## 2. Research Methodology

To investigate the connection between FDI and economic growth in Papua New Guinea (PNG), this paper uses a theoretical-empirical hybrid research design that combines quantitative and conceptual methodologies. The quantitative component evaluates the statistical significance and nature of the link between FDI net inflows and GDP growth using time-series data spanning 21 years (2002–2022). The theoretical component interprets the structural constraints influencing the developmental impact of foreign direct investment (FDI) in resource-based economies by using contextual analysis and well-established development economics literature, particularly the Enclave Economy Hypothesis and Endogenous Growth Theory.

### 2.1 Inclusion and exclusion criteria

This study employed inclusion and exclusion criteria to guarantee the relevance and quality of the examined literature. The inclusion criteria encompassed peer-reviewed journal papers, official reports, and academic publications released from 2000 to 2024, concentrating on FDI and economic growth, specifically in developing nations and the setting of PNG. We considered only English-authored sources that were accessible through established academic databases. The exclusion criteria encompassed the removal of non-academic sources, including blog posts, opinion articles, research predating 2010, and publications that failed to examine the relationship between FDI and economic growth directly or lacked a theoretical foundation. The selection method guaranteed that the study relied on reputable, contemporary, and thematically pertinent literature.

### 2.2 Ethical considerations

The research relies solely on secondary data and theoretical analysis, thereby eliminating any ethical hazards related to human participants. Nonetheless, proper academic integrity is upheld through proper citation and referencing of all utilized sources.

### 2.3 Scope & limitations

The paper is conceptual and theoretical, with a potential basis in secondary sources. There is a lack of primary data on economic validations of the eco-living nature of FDI data in PNG, which may not always align neatly with theoretical speculations.

## 3. Literature review

Chowdhury (1998) explores the macroeconomic effect of resource booms in Papua New Guinea and highlights the complex relationship between foreign direct investment (FDI), exchange rate fluctuations, and economic stability. Using a theoretical framework rooted in open-economy macroeconomics, the paper stresses that while FDI inflows have stimulated economic activity during resource-rich periods, they have also introduced volatility, particularly when institutional responses and policy frameworks have been weak or procyclical. This suggests that the presence of FDI alone is insufficient to sustain economic growth unless supported by robust macroeconomic management.

Feeny, Iamsiraroj, & McGillivray (2014) deliver regional evidence from Pacific Island countries, including Papua New Guinea, and argue that the relationship between FDI and growth is highly conditional on governance quality, trade openness, and the effectiveness of public institutions. Their econometric analysis finds that FDI exerts a statistically significant effect on growth only when institutional indicators, such as legal transparency and bureaucratic quality, surpass a certain threshold. This reinforces the theoretical proposition from endogenous growth models that FDI contributes to long-term growth primarily through technology diffusion and human capital enhancement, both of which require absorptive capacity within host countries.

Kuwimb (2010) applies a critical political economy lens to observe Papua New Guinea's experience with resource-based FDI and encounters transformation theory's assumption that capital inflows naturally lead to industrial transformation. Drawing from the resource expletive literature, he argues that extractive-sector investments have often reinforced structural dependency, weakened state institutions, and displaced indigenous economic systems. The paper concludes that unless FDI is reoriented toward broader development objectives, including rural development, infrastructure, and education, its long-term impact will remain limited or even detrimental.

Faal (2006) engages a progress accounting framework to assess productivity trends in Papua New Guinea and finds that the contribution of capital, including FDI, has been modest due to inefficiencies in labor markets and weak complementary investments in technology and skills. His analysis identifies governance constraints, such as policy inconsistency and institutional fragility, as critical barriers that inhibit the full realization of FDI's growth potential. These findings lend empirical support to theoretical arguments emphasizing the importance of the domestic policy environment in mediating the effects of foreign investment.

McKenzie (2021) shifts the focus to legal and institutional frameworks by analyzing the potential of International Investment Agreements (IIAs) to facilitate development-oriented FDI in

the Pacific. While IIAs can enhance investor confidence by offering dispute resolution and legal safeguards, their developmental benefits hinge on how they are implemented within the domestic legal system. In the case of Papua New Guinea, the study suggests that alignment between international commitments and national development strategies remains weak, resulting in legal uncertainty and investor hesitancy.

Parry (1988), in one of the earliest assessments of FDI in Papua New Guinea, critiques the country's fragmented investment policies and notes that a lack of coherent long-term planning has often led to ad hoc and unbalanced investment flows, particularly in mining and energy. His work highlights the tension between economic nationalism and liberal investment regimes and calls for a more strategic approach that ensures resource rents are reinvested in domestic economic diversification.

Lea (2000) revises Papua New Guinea's development trajectory through the lens of dependency theory and asserts that foreign investment, particularly in enclave industries such as oil and gas, has done little to stimulate local entrepreneurship or reduce structural unemployment. The theoretical framework employed underscores the dangers of economic externalization, where foreign capital dominates key sectors, limiting domestic agencies in shaping growth patterns.

Keita and Baorong (2022), analyzing data from Guinea, a resource-rich country with structural parallels to Papua New Guinea, reinforce the endogenous growth theory by demonstrating that FDI positively affects GDP growth when targeted toward productive sectors and combined with investments in education and infrastructure. Their study offers comparative value, illustrating how structural conditions can amplify or mitigate the impact of FDI across different resource economies.

Feeny (2005) investigates the parallel case of foreign aid in Papua New Guinea and concludes that aid, like FDI, fails to deliver growth dividends in the absence of institutional reform. While his analysis focuses on aid flows, the underlying logic extends to private capital, highlighting that external inflows are not substitutes for domestic policy discipline. The findings underscore the broader theoretical proposition that capital must be complemented by effective governance, policy coherence, and long-term planning to translate into meaningful development outcomes.

McKenzie (2021), reinforcing her earlier conclusions, also notes that many Pacific Island countries, including Papua New Guinea, lack the legal infrastructure and negotiation capacity to draft IIAs that balance investor protections with development goals. This limits their ability to attract "quality" FDI investment that is both productive and aligned with national interest, thus continuing cycles of extraction-led, short-term growth.

Read (2008) offers a broader regional perspective by examining small island developing states and concludes that while FDI is vital for overcoming domestic capital constraints, its impact is asymmetrical, often favoring investor returns over local development. Papua New Guinea's experience is consistent with these patterns, particularly in sectors like mining, where value-added processing is often conducted offshore, depriving the host economy of downstream benefits.

## 4. Discussion and synthesis

Data for the study were sourced from the World Bank Open Data Platform

Table 1: Growth rate of GDP and FDI (net inflows) in Papua New Guinea

| Year | Growth rate of GDP (annual %) | Foreign Direct Investment, Net Inflows (Annual %) |
|---|---|---|
| 2002 | -0.1589 | 0.672123736 |
| 2003 | 2.164103 | 4.767668112 |
| 2004 | 2.721176 | 0.828665064 |
| 2005 | 6.344796 | 0.821562763 |
| 2006 | 5.409944 | 1.538594752 |
| 2007 | 7.815189 | 1.368617084 |
| 2008 | -0.296457846 | 0.410070468 |
| 2009 | 6.800421 | 3.614960513 |
| 2010 | 10.12845 | 0.249749809 |
| 2011 | 1.107544 | 0.202496659 |
| 2012 | 4.65712 | 0.135226482 |
| 2013 | 3.824946 | 0.126069328 |
| 2014 | 13.54377 | 0.126824295 |
| 2015 | 6.578356 | 0.138228028 |
| 2016 | 5.489573 | -0.18841703 |
| 2017 | 3.534611 | -0.78823631 |
| 2018 | -0.27925 | 1.271855264 |
| 2019 | 4.480431 | 1.355788643 |
| 2020 | -3.16738 | 0.473794552 |
| 2021 | -0.78033 | -0.04102307 |
| 2022 | 5.165051 | 1.033789391 |

Source: worldbank.org (2002-2022)

The dataset contains yearly statistics for the following from 2002 to 2022:

- The GDP growth rate (%) is a measure of the state of the economy.
- The amount of foreign capital inflows about economic size is measured by foreign direct investment net inflows as a percentage of GDP.

All values are standardized in percentage terms to enable comparison and regression modeling. The choice of variables is guided by prior literature on FDI-growth relationships (Borensztein, De Gregorio, & Lee, 1998; Alfaro et al., 2004).

As seen in Figure 2, the economy saw significant swings in both GDP growth and FDI inflows between 2002 and 2022. Following a recession in 2002, the early 2000s saw a period of recovery, with GDP growth increasing gradually through 2007 and reaching a peak of 7.81%. This rebound was driven by global economic expansion, robust commodity demand, and financial liberalization in many emerging markets (Canuto, 2023). Improved investor confidence, trade openness, and structural reforms in developing economies are all factors contributing to the spike in FDI inflows during this time, which peaked in 2003 at 4.77% (Kalai et al., 2025; Melega et al., 2021).

However, this increasing trajectory was broken by the global financial crisis of 2008. Figure 2 illustrates the sharp decline in FDI inflows to a low of 0.41% and the plunge into negative GDP growth. Investor risk aversion, the global credit crunch, and the collapse of global trade volumes all played a part in this dramatic decline (Al-Kasasbeh, Alzghoul, & Alghraibeh, 2022; Karahan & Bayır, 2022). FDI inflows were muted in 2010, even though GDP recovered

significantly to over 10%, mostly because of stimulus packages and a spike in local demand (Dua & Verma, 2023). This suggests a discrepancy between the sentiment of foreign investors and the domestic economic recovery.

Growth slowed between 2011 and 2016, and FDI inflows steadily decreased, even going negative in 2016 and 2017. Long-term structural issues like political unpredictability, uneven regulatory frameworks, and deteriorating institutional frameworks in many developing countries are to blame for this prolonged decline in foreign investment (Chigeza, 2023; Koçak & Barış-Tüzemen, 2022). Despite modest GDP growth, the investment climate during this time lacked the stability and predictability that foreign investors were looking for, according to the data.

This trend was made worse by the COVID-19 pandemic's effects in 2020. A significant GDP decrease and consistently low or negative FDI inflows are depicted in Figure 2. Capital flows were stopped, and investment decisions were delayed due to global lockdowns, supply chain disruptions, and increased uncertainty (Firdos et al., 2024; Melega et al., 2021). But by 2022, there were indications of improvement. FDI inflows climbed to 1.03%, while GDP growth recovered to 5.17%. Global immunization campaigns, economic openings, and rekindled investor interest in resilient industries like digital infrastructure and renewable energy are all factors contributing to this small comeback (Nguyen & Poczta-Wajda, 2024; Hambolu, Ojogbo, & Alliu, 2024).

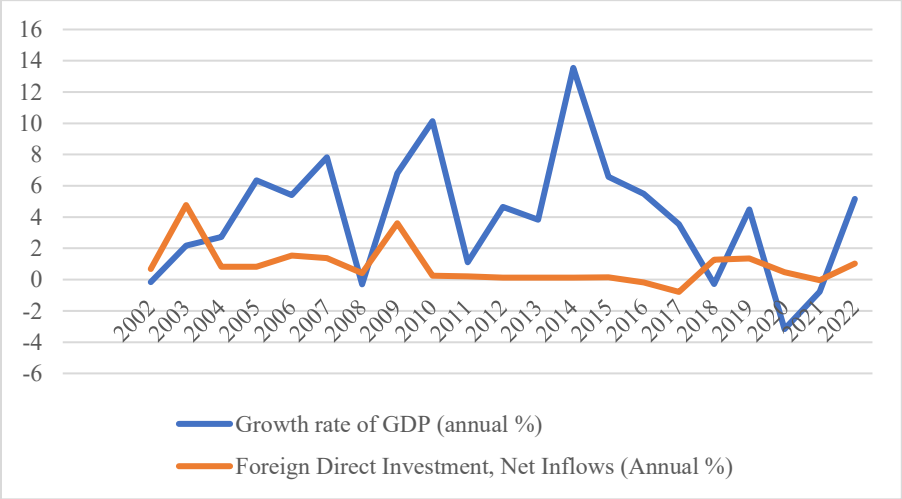


Figure 2: Growth rate of GDP & FDI in Papua New Guinea
Source: worldbank.org (2002-2022)

Significant differences between economic performance and foreign investment behaviour are shown in Figure 2, which contrasts GDP growth rates and FDI net inflows from 2002 to 2022. With notable recovery in 2010 and 2014 and strong reductions in 2008, 2018, and 2020, the blue line representing GDP growth exhibits notable instability (Table 1; Fig. 2). These trends reflect both internal macroeconomic policy responses and exogenous shocks like the COVID-19 pandemic and the global financial crisis of 2008 (Karahan & Bayır, 2022; Koçak & Barış-Tüzemen, 2022).

With inflows usually staying within a limited range even during times of economic expansion or contraction, the orange line showing FDI net inflows, on the other hand, shows a more conservative and constrained band of movement. Because of this stability, foreign investors tend to view investment environments more long-term and risk-sensitively, responding more to

structural factors like political stability, institutional quality, and global capital market conditions than to short-term GDP fluctuations (Firdos et al., 2024; Chigeza, 2023).
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It is interesting to note that FDI inflows and GDP growth do not clearly or consistently correlate. High growth by itself does not ensure more foreign investment, as demonstrated by the fact that in 2014, FDI levels stayed unchanged despite a sharp increase in GDP growth. Similarly, FDI only slightly improved during economic regaining years like 2009 and 2022, highlighting the reality that a variety of factors, such as global capital flows, governance quality, policy stability, and the regulatory environment, affect investor confidence.

The intrinsic volatility of foreign direct investment (FDI) in relation to GDP performance is depicted in both Figure 2 and Table 1, highlighting the intricate and frequently unequal relationship between short-term economic output and long-term investment behaviour. FDI inflows typically react more conservatively to local cycles and global shocks than GDP growth rates, which are influenced by more profound factors including political stability, regulatory predictability, and institutional quality. This discrepancy emphasises how crucial structural changes, solid macroeconomic management, and reliable governance frameworks are to drawing in and keeping foreign investment. The findings essentially highlight the fact that stable and open policy frameworks are more important for attracting long-term foreign direct investment than short-term spikes in economic growth.

Table-2: Result of Correlational Analysis

| | | | |
|---|---|---|---|
| Growth rate of GDP | Pearson correlation | 1 | 0.000 |
| | Sig. (2- tailed) | | 1.000 |
| | N | 21 | 21 |
| Growth rate of FDI | Pearson correlation | 0.000 | 1 |
| | 2 tailed | 1.000 | |
| | N | 21 | 21 |

Source: Literature survey

The correlational analysis shows a Pearson correlation coefficient of 0.000 between GDP growth and FDI growth, with a p-value of 1.000. This means there is no linear relationship between the two variables, and the result is not statistically significant. In simple terms, changes in GDP growth do not influence FDI inflows, suggesting that foreign investment is driven by other factors beyond economic performance alone.

Table 3: Model Summary

| Model | R | R square | Adjusted R square | Std. error of the estimate |
|---|---|---|---|---|
| 1 | $0.000^{a}$ | 0.000 | -0.053 | 4.047524449 |
| | | | | |

a. Predictors: (Constant), Growth Rate of GDP Annual

There is no linear association between the predictor (Growth Rate of GDP Annual) and the outcome variable, according to the model's correlation coefficient (R) of 0.000. The model accounts for 0% of the variance in the dependent variable, as indicated by the R-squared value of 0.000. The model does not appear to enhance prediction beyond utilizing the dependent variable's mean, as indicated by the somewhat negative Adjusted R-squared (-0.053). The model's prediction error is reflected in the standard error of the estimate (4.05), which shows the average departure between the observed values and the regression line.

Table- 4: ANOVA

| Model | Sum of squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | 0.000 | 1 | 0.000 | 0.000 | $1.000^b$ |
| Residual | 311.267 | 19 | 16.382 | | |
| Total | 311.267 | 20 | | | |

a. Predictors: (Constant), growth rate of FDI
b. Dependent variable: Growth rate of GDP

The regression model is not statistically significant, according to the ANOVA results (F = 0.000, p = 1.000). This indicates that there is no substantial correlation between the growth rate of FDI and the GDP growth rate. Comparing the residual variation explained by the model, is insignificant.

Table 5: Coefficients

| **Model** | | **Coefficients[a]** | | | | **95.0% confidence Interval for B** | |
|---|---|---|---|---|---|---|---|
| | | **Unstandardized coefficients** | | **t** | **Sig.** | | |
| | | **B** | **Std. error** | | | **Lower Bound** | **Upper Bound** |
| 1 | (Constant) | 4.051 | 1.078 | 3.5759 | 0.001 | 1.795 | 6.307 |
| | Growth rate of FDI | 0.000 | 0.716 | 0.001 | 1.000 | -1.498 | 1.499 |

According to Table 5, when the growth rate of FDI is zero, the expected GDP growth rate is around 4.05. This is because the constant intercept is 4.051 and statistically significant (p = 0.001). With a very high p-value (1.000) and a coefficient of 0.000 for the growth rate of FDI, it is clear that FDI has no discernible impact on GDP growth. Uncertainty around this estimate is further demonstrated by the large confidence interval (-1.498 to 1.499)

## 5. Key Findings

- There is no statistically significant correlation between FDI inflows and GDP growth in Papua New Guinea from 2002 to 2022, as shown by a Pearson correlation coefficient of 0.000.

- Most foreign direct investments (FDI) in Papua New Guinea are focused on resource-related industries, especially mining and oil, which provide few jobs and few connections to the wider economy.
- Due to adverse internal conditions and limited absorptive capacity, FDI inflows have frequently failed to support sustained growth, instead contributing to economic volatility.
- FDI's impact on growth is heavily reliant on trade openness, the strength of public institutions, and the quality of governance; without these, FDI has little developmental impact.

## 6. Recommendations

- By offering incentives for manufacturing, infrastructure, tourism, education, and agriculture, as well as by establishing sectoral targets to direct investment towards industries with strong value chain integration and high job creation, we may encourage foreign direct investment (FDI) in a variety of industries beyond resources.
- To lower investor uncertainty and boost long-term FDI trust, strengthen the regulatory and governance environment by developing clear legal frameworks, guaranteeing consistency in policy implementation, and increasing transparency in contract enforcement.
- Create institutional mechanisms that boost FDI's developmental impact. These include tying investment inflows to national development plans, bolstering FDI project monitoring and evaluation systems, and guaranteeing alignment with social and economic priorities like regional equity and inclusive employment.
- Prioritise industries other than extractives, increase connectivity in disadvantaged areas, and integrate infrastructure planning with FDI policy to improve market access and lower logistical hurdles for inclusive growth to align infrastructure investment with economic diversification goals.
- Establish a centralised investment coordination body to guarantee consistent policy signals, enhance aftercare services, and increase investor trust. Reform strategic investment planning by institutionalising long-term FDI frameworks that are transparent, inclusive, and in line with national development plans.

## 7. Implications for policy and practice

The results indicate a significant necessity for Papua New Guinea (PNG) to broaden its export portfolio beyond dependence on commodities and petroleum. This has evident policy consequences, as the government ought to concentrate on boosting non-extractive sectors such as agriculture, fisheries, and value-added manufacturing. Diversification helps mitigate economic risk and create more sustainable income sources. This necessitates strategic investments, favorable legislation, and infrastructure to enable small-scale producers to reach foreign markets and comply with export standards, especially in Asia and Europe.

The instability of resource-based revenues highlights the necessity of prudent fiscal and monetary policy to regulate resource booms. PNG ought to contemplate the establishment of instruments such as sovereign wealth funds or the implementation of counter-cyclical fiscal measures to mitigate economic swings. This entails guaranteeing transparent and accountable administration of natural resource earnings, preventing excessive expenditure during prosperous

periods, and allocating surplus funds towards long-term investments that benefit future generations.

Successful trading necessitates a strong support framework, encompassing both physical infrastructure and institutional capability. Policy interventions must prioritize the enhancement of transportation networks, port infrastructure, and digital connectivity to optimize trade efficiency. Practically, customs agencies and trade ministries must be sufficiently staffed, trained, and equipped to support exporters. Public-private partnerships can significantly contribute to the funding and management of trade-related infrastructure and services.

## 8. Conclusions

According to this theoretical and empirical analysis, FDI inflows into Papua New Guinea have not resulted in appreciable GDP growth throughout the 2002–2022 timeframe. The lack of a statistical correlation emphasizes how crucial sectoral allocation and institutional environment are in assessing how foreign investment affects development.

FDI's efficacy as a tool for inclusive growth has been hindered by its overconcentration in enclaved industries like mining and gas, which have few jobs, little innovation spillover, and few domestic ties. According to the findings, which are consistent with endogenous growth and enclave economy theories, FDI is unlikely to produce lasting prosperity unless it is integrated into a larger development strategy that includes infrastructure, human capital, and policy coherence.
Therefore, PNG must shift from a passive recipient of FDI to an active investment strategist, channeling foreign capital into high-multiplier sectors and supporting reforms that enhance its absorptive capacity.

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