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The Effect of Artificial Intelligence in Smart Cities on Foreign Direct Investment

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Abstract

Artificial intelligence (AI) is increasingly becoming part of the infrastructure through which modern cities organize economic activity, deliver public services, and compete for investment. At the same time, foreign direct investment (FDI) remains an important source of capital, employment, technology transfer, and integration into global value chains. This paper examines how AI-enabled smart-city development can influence the attraction and quality of FDI. Drawing on the literature on smart cities, international business, innovation, and location advantages, the paper develops a conceptual framework linking AI development with FDI through five main mechanisms: improvements in the business environment, digital infrastructure, innovation capacity, digital human capital, and digital financial development. Existing empirical evidence provides support for this relationship. Research on Chinese cities shows that smart-city development can improve the quality of FDI, while more recent evidence from 290 Chinese cities indicates that intelligent development can attract FDI through digital human capital, regional innovation, and digital financial inclusion (Ye et al., 2021; Does Intelligent Development Attract Foreign Direct Investment, 2026). Evidence from OECD countries also suggests that newly funded AI firms are positively associated with FDI flows (Grigoriadi, 2026). At the international level, recent evidence indicates that AI-related digital infrastructure has become an increasingly important component of global investment. The World Investment Report 2026 reports that global FDI increased by 6% in 2025 to approximately US\$1.6 trillion, with much of the increase associated with a limited number of large projects, particularly in AI-related digital infrastructure (UN Trade and Development, 2026). However, AI should not be considered an automatic determinant of FDI. Its effects depend on complementary factors including institutional quality, regulatory predictability, digital infrastructure, skilled labor, reliable energy, innovation capacity, and the ability of cities to connect foreign investors with local economic ecosystems. The paper argues that AI can become an important urban location advantage when it is integrated into a broader strategy of economic development and international competitiveness.

Keywords: artificial intelligence; smart cities; foreign direct investment; FDI; digital economy; urban competitiveness; innovation; digital infrastructure; human capital.

1. Introduction

Cities have always competed for investment. Historically, this competition was largely shaped by factors such as market size, labor costs, transportation infrastructure, access to natural resources, political stability, and proximity to customers and suppliers. These factors continue to matter, but the economic environment in which cities compete is changing rapidly.

One of the most important changes is the emergence of artificial intelligence.

AI is moving beyond its traditional association with technology companies and research laboratories. It is increasingly being applied to transportation, energy management, healthcare, logistics, financial services, manufacturing, public administration, and urban planning. As these applications become more widespread, cities are developing increasingly sophisticated digital systems capable of collecting, processing, and using large amounts of information.

This transformation raises an important question for international business and urban economics: Does the development of AI within smart cities make those cities more attractive to foreign direct investment?

The question is important because multinational enterprises increasingly consider technological and digital capabilities when deciding where to locate their activities. A company choosing a location for a research Centre, regional headquarters, advanced manufacturing facility, data Centre, financial operation, or digital service may evaluate not only traditional infrastructure and market conditions but also access to skilled workers, digital networks, innovation institutions, data infrastructure, and technologically capable public authorities.

The relationship between smart cities and FDI has already received attention in the academic literature. Ye et al. (2021), for example, examined 226 Chinese prefecture-level cities between 2006 and 2017 and found that smart-city construction significantly improved the quality of FDI in pilot cities. Their analysis used a difference-in-differences approach and reported that the results remained robust after additional tests. Wiley Online Library+1

More recent research has moved closer to the specific role of intelligent and AI-related development. A 2026 study based on 290 Chinese cities between 2012 and 2022 found that intelligent development significantly attracted FDI. The study identified digital human capital, regional innovation, and digital financial inclusion as important mechanisms. It also reported that intelligent technology adoption and policy implementation were more influential than digital infrastructure alone (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

Evidence from OECD countries provides another perspective. Grigoriadi (2026) examined 25 OECD countries and found that newly funded AI firms were positively associated with FDI flows. The study therefore suggests that a dynamic AI entrepreneurial environment may contribute to a country's attractiveness to international capital. At the same time, the findings concerning AI patents were more complex, indicating that technological capability does not automatically translate into greater investment. Wiley Online Library+1

The international investment environment is also changing. According to the *World Investment Report 2026*, global FDI

increased by 6% in 2025, reaching approximately US\$1.6 trillion. However, the recovery was uneven, and much of the increase was associated with a small number of large projects, particularly in AI-related digital infrastructure (UN Trade and Development, 2026). Investment Policy Hub+1

These developments suggest that AI may be changing the geography of international investment. The issue is no longer simply whether a city has good roads, ports, industrial zones, or inexpensive labor. Increasingly, cities are also competing in terms of digital infrastructure, technological capabilities, talent, innovation, and the ability to support data-intensive economic activities.

This paper examines that emerging relationship. It argues that AI does not directly or automatically generate FDI. Instead, AI can strengthen a series of urban capabilities that influence the location decisions of multinational enterprises.

The central proposition is therefore that AI-enabled smart-city development can influence FDI by improving the digital, institutional, human, and innovative capabilities of cities.

2. Smart Cities and the Rise of Artificial Intelligence

The concept of the smart city has changed considerably over time.

Early smart-city initiatives were primarily concerned with information and communication technologies, internet connectivity, sensors, and the digitalization of government services. Over time, the concept developed into a broader approach involving the integration of infrastructure, data, public institutions, businesses, and citizens.

Artificial intelligence represents an important development within this process.

Traditional digital systems can collect and communicate information. AI systems can go further by identifying patterns, generating predictions, supporting decisions, and, in some cases, automating complex processes.

For example, a conventional transportation system may provide information about traffic congestion. An AI-enabled transportation system can analyze real-time and historical data to predict congestion and adjust traffic management accordingly.

Similar applications can be found in energy systems, healthcare, water management, waste collection, public administration, and infrastructure maintenance.

The economic implications of these technologies can be significant. When urban systems become more efficient, businesses may face lower transaction costs and greater predictability.

However, the existence of technology alone does not make a city economically competitive.

A city may install sensors and digital platforms without developing the human capital, institutions, innovation networks, or business environment required to transform those technologies into economic value.

This distinction is particularly important when considering FDI.

Multinational enterprises do not necessarily invest in a city simply because it uses AI. They invest when the technology contributes to a broader set of location advantages.

3. Foreign Direct Investment and Location Advantages

FDI represents an important component of the international economy. It can provide host economies with capital, employment, technology, managerial knowledge, access to global markets, and opportunities to participate in international production networks.

However, foreign investment is not distributed equally across locations.

Multinational enterprises evaluate alternative locations according to a combination of economic, institutional, technological, and strategic considerations.

Dunning's (1977, 1988) eclectic paradigm provides one of the most influential theoretical frameworks for understanding international investment. The OLI paradigm emphasizes three types of advantages: ownership advantages, location advantages, and internalization advantages.

AI can potentially influence the location component of this framework.

A city with strong AI infrastructure, skilled workers, innovative firms, universities, and effective digital government may offer multinational enterprises advantages that are increasingly important in knowledge-intensive industries.

The relevance of AI to international investment is emerging in recent research. Grigoriadi (2026), for example, applies the OLI framework to AI-related capabilities and examines their relationship with FDI flows across 25 OECD countries. The study finds that newly funded AI firms are positively associated with investment flows, suggesting that an active AI business environment may function as a location advantage. Wiley Online Library

This does not mean that AI replaces traditional location advantages. Rather, AI adds another layer to the factors that multinational enterprises may consider when making investment decisions.

4. Mechanisms Linking AI and FDI

4.1 Improving the Business Environment

One of the most important mechanisms through which AI can affect FDI is the business environment.

Foreign investors generally prefer locations where administrative procedures are efficient, infrastructure is reliable, information is accessible, and government services are predictable.

AI can support these conditions.

For example, governments can use AI and data analytics to identify administrative bottlenecks, improve infrastructure maintenance, manage traffic, process information, and provide more responsive public services.

When these systems work effectively, they can reduce some of the costs and uncertainties associated with doing business.

Research on smart-city development in China supports this argument. He et al. (2021) found that smart-city pilot programs contributed to FDI attraction and identified improvements in the business environment as one of the mechanisms behind the relationship.

The important point is that foreign investors may not value AI simply because it is technologically advanced. Instead, they may value the improvements in efficiency and predictability that AI can help produce.

5. Digital Infrastructure as a New Location Advantage

AI requires substantial digital infrastructure.

High-speed telecommunications, cloud computing, data centers, cybersecurity systems, and reliable electricity are increasingly important for AI-intensive activities.

This creates a direct connection between smart-city development and international investment.

A city that develops strong digital infrastructure may become more attractive to companies whose operations depend heavily on data and computing capacity.

At the same time, FDI can contribute to the development of that infrastructure.

This creates the possibility of a reinforcing process:

Digital infrastructure → greater investment attractiveness → FDI → additional infrastructure development.

Recent international investment data provide evidence that this process is becoming increasingly relevant.

The *World Investment Report 2026* reports that much of the growth in global FDI in 2025 was associated with large investment projects, particularly in AI-related digital infrastructure (UN Trade and Development, 2026). Investment Policy Hub

UN Trade and Development also reports that strategic sectors accounted for 44% of global greenfield investment value in 2025, compared with 16% in 2020. These strategic sectors include AI infrastructure, semiconductors, critical minerals, and energy-transition technologies (UN Trade and Development, 2026). UNCTAD

These figures suggest that AI infrastructure is becoming not only a tool used by investors but also a destination for investment itself.

6. AI and Innovation Capacity

Innovation is another important mechanism linking AI and FDI.

Multinational enterprises often prefer locations where they can access universities, research institutions, skilled workers, innovative firms, suppliers, and knowledge networks.

This helps explain why FDI is frequently concentrated in major metropolitan areas and established technology clusters.

AI can strengthen these ecosystems by encouraging collaboration between firms, universities, governments, and entrepreneurs.

Universities may establish AI research centers. Governments may support technology incubators. Existing companies may create

research and development units. Start-ups may develop AI applications for local industries.

These activities can increase the attractiveness of a city to foreign investors.

The recent evidence from Chinese cities supports this interpretation. The 2026 study of 290 cities found that regional innovation was one of the mechanisms through which intelligent development attracted FDI (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

This suggests that multinational enterprises may be attracted not simply by individual technological projects but by the broader innovation ecosystem surrounding them.

7. Digital Human Capital

Technology ultimately depends on people.

AI-intensive economic activities require workers capable of developing, managing, implementing, and using advanced digital technologies.

This includes AI specialists and data scientists, but the need extends beyond these occupations. Engineers, managers, economists, lawyers, financial professionals, cybersecurity specialists, designers, and other workers increasingly require digital competencies.

Human capital can therefore be an important part of the relationship between AI and FDI.

A city with advanced digital infrastructure but insufficient skilled workers may find it difficult to attract and retain technology-intensive multinational enterprises.

By contrast, cities with strong universities, research institutions, technical education, and training systems may be better positioned to attract international investment.

The recent evidence from China provides direct support for this argument. The 2026 city-level study identified digital human capital as one of the mechanisms through which intelligent development attracts FDI (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

This finding has an important policy implication: investment in AI infrastructure should be accompanied by investment in education and skills.

8. Digital Financial Development

AI and digital technologies may also influence FDI through financial development.

Digital financial platforms can reduce transaction costs and improve access to payments, credit, financial information, and other services.

These developments can make it easier for foreign companies to interact with domestic firms, suppliers, customers, and financial institutions.

The 2026 study of Chinese cities identifies digital financial inclusion as another mechanism connecting intelligent development with FDI (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

This is particularly important because the relationship between AI and FDI is not limited to technology companies.

AI-enabled financial systems, logistics platforms, digital payment systems, and data-driven business services may influence investment in manufacturing, retail, transportation, finance, and other sectors.

9. FDI Quantity Versus FDI Quality

An important issue in the discussion of FDI is that more investment is not necessarily equivalent to better economic outcomes.

The characteristics of investment matter.

Some foreign investments generate highly skilled employment, research and development, technology transfer, supplier linkages, and knowledge spillovers. Other investments may generate fewer connections with the local economy.

This distinction is particularly important when considering smart cities and AI.

Ye et al. (2021) examined 226 Chinese prefecture-level cities and found that smart-city construction significantly improved the quality of FDI in pilot cities. Their study used a difference-in-differences methodology and reported robust results after additional tests. Wiley Online Library+1

This finding suggests that smart-city policies may influence not only the amount of foreign investment but also the type of investment a city is able to attract.

The distinction is increasingly relevant as AI becomes part of international investment.

An AI research center, advanced manufacturing facility, technology-oriented headquarters, or digital services operation may generate different local benefits from a low-value investment based primarily on inexpensive labor.

Consequently, policymakers should consider the quality, productivity, and local embeddedness of FDI, rather than focusing exclusively on aggregate investment volumes.

10. The Changing Global Investment Environment

The international investment environment provides important context for the growing relationship between AI and FDI.

According to the *World Investment Report 2026*, global FDI increased by 6% in 2025 to approximately US\$1.6 trillion after two years of decline. However, the recovery was uneven: FDI inflows into developed economies increased by 11%, while developing economies recorded only 2% growth, reaching approximately US\$901 billion (UN Trade and Development, 2026). Investment Policy Hub+1

The concentration of investment is particularly important.

UN Trade and Development reports that the world's 20 largest host economies attracted more than 80% of global FDI in 2025 (UN Trade and Development, 2026). Investment Policy Hub

At the same time, strategic sectors are becoming increasingly important. The value of announced projects in strategic sectors rose substantially between 2020 and 2025, with AI infrastructure among

the areas experiencing rapid growth (UN Trade and Development, 2026). UNCTAD

These developments indicate that international investment is becoming increasingly concentrated around specific technologies, sectors, and locations.

For cities, this creates both an opportunity and a challenge.

Cities with the necessary infrastructure and skills may attract new forms of investment. Cities without these capabilities may find it more difficult to participate in the emerging AI-driven investment economy.

11. AI and the Transformation of Traditional Location Advantages

AI does not eliminate traditional location advantages. Instead, it adds new dimensions to them.

Historically, multinational enterprises considered:

- market size;
- labor costs;
- transportation;
- natural resources;
- access to suppliers;
- political stability; and
- physical infrastructure.

Increasingly, these factors are being complemented by:

- digital connectivity;
- computing capacity;
- data infrastructure;
- AI talent;
- research institutions;
- innovation ecosystems;
- cybersecurity;
- digital government; and
- regulatory capacity.

This suggests that urban competitiveness is becoming both physical and digital.

A data center still requires land, electricity, connectivity, and cooling. A technology company still needs skilled employees. An AI-enabled manufacturing operation still needs transportation and suppliers.

AI therefore complements traditional location advantages rather than making geography irrelevant.

12. Institutional Quality and Regulation

Technology alone cannot guarantee FDI attraction.

Institutions remain essential.

Foreign investors need predictable regulations, effective contract enforcement, intellectual property protection, data governance, and reasonable levels of policy certainty.

AI makes these issues even more important.

As firms increasingly depend on data and algorithms, regulations concerning data protection, cybersecurity, cross-border data flows, intellectual property, and AI governance become part of the investment environment.

The OECD has emphasized the importance of effective governance and institutional frameworks in the development of trustworthy AI and digital transformation.

The international evidence also suggests that investors respond to actual economic and institutional conditions rather than simply to political discussion of AI. Grigoriadi (2026), for example, found that mentions of AI in legislative proceedings did not significantly influence investment flows in the studied models, whereas newly funded AI firms showed a positive relationship with investment flows. Wiley Online Library

This distinction is useful.

Investors may respond more strongly to evidence that an economy has developed functioning AI capabilities than to statements that governments intend to develop them.

13. Energy and Sustainability

The expansion of AI also creates new infrastructure requirements, particularly in relation to energy.

Large-scale computing facilities and data centers require significant amounts of electricity and cooling.

This creates an additional consideration for cities seeking AI-related investment.

A city may have strong digital connectivity but still face difficulties attracting large AI projects if its electricity supply is unreliable or if the necessary energy infrastructure cannot expand at a reasonable cost.

This means that AI investment policy cannot be separated completely from energy policy.

For developing economies, the issue may be particularly important because large technology projects can place substantial demands on existing infrastructure.

A sustainable AI strategy therefore requires attention to energy reliability, infrastructure investment, and environmental considerations.

14. Uneven Regional Development

AI-related investment may also increase differences between regions.

Technology-intensive investment often concentrates in locations that already have strong infrastructure, universities, financial systems, and skilled workers.

This can create a cumulative process:

strong digital ecosystem → more investment → more talent → more innovation → stronger digital ecosystem.

The reverse process is also possible.

Cities that lack skilled workers, infrastructure, and investment may find it increasingly difficult to catch up.

The 2026 evidence from Chinese cities provides support for this concern. The authors report significant regional heterogeneity in the effect of intelligent development on FDI, with stronger effects in certain geographical and commercially attractive cities (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

This suggests that AI policies should be adapted to local economic conditions.

15. Developing Economies

The relationship between AI, smart cities, and FDI is particularly relevant to developing economies.

FDI can provide capital and technology that developing cities need to improve infrastructure and productivity. At the same time, digital technologies may allow some cities to develop new economic activities without following exactly the same development path as earlier industrial economies.

Digital financial services are one example.

AI-enabled financial technologies can improve access to financial services, while digital logistics can improve connections between producers and international markets.

However, developing economies also face major constraints.

These include:

- shortages of advanced skills;
- limited digital infrastructure;
- unreliable electricity;
- restricted access to finance;
- institutional weaknesses;
- limited research capacity; and
- difficulties retaining skilled workers.

These constraints can limit the ability of cities to benefit from AI-related FDI.

The *World Investment Report 2026* highlights this broader concern, noting that many developing economies risk being left behind as international investment becomes increasingly concentrated in strategic sectors such as AI infrastructure and advanced technologies (UN Trade and Development, 2026). UNCTAD+1

For developing cities, the objective should therefore not simply be to imitate established global technology centres.

Instead, cities should identify areas where AI can strengthen their existing economic advantages.

For example, a major port city could develop AI-enabled logistics. A manufacturing city could focus on intelligent production. A financial centre could develop AI-based financial services. A university city could focus on AI research and entrepreneurship.

This approach connects AI investment with existing economic capabilities.

16. Conceptual Framework

Based on the literature, this paper proposes a conceptual framework in which AI-enabled smart-city development affects FDI through five main channels.

AI-enabled smart-city development



Digital infrastructure

Data centers, telecommunications, cloud computing, cybersecurity, and digital platforms.



Business environment

More efficient government services, administration, transportation, and infrastructure management.



Innovation capacity

Universities, research institutions, start-ups, technology firms, and knowledge networks.



Digital human capital

AI skills, technical education, researchers, engineers, and digitally capable managers.



Digital financial development

Digital payments, financial inclusion, digital credit, and improved business connectivity.



Improved urban location advantages



Greater attractiveness to multinational enterprises



FDI attraction and potentially higher-quality FDI

The framework also recognizes the role of moderating conditions, including institutional quality, regulatory predictability, energy availability, market size, international connectivity, and macroeconomic stability.

17. Research Hypotheses

The conceptual framework produces several hypotheses that can be examined empirically.

H1: AI-enabled smart-city development and FDI

AI-enabled smart-city development has a positive relationship with FDI inflows.

The rationale is that AI can strengthen the infrastructure, efficiency, innovation capacity, and technological capabilities of cities.

H2: AI and FDI quality

AI-enabled smart-city development is positively associated with the quality of FDI.

Cities with stronger technological and innovation capabilities may be more capable of attracting knowledge-intensive and technology-oriented investment.

H3: Innovation as a mediating mechanism

Innovation capacity mediates the relationship between AI-enabled smart-city development and FDI.

AI development may strengthen collaboration between firms, universities, research institutions, and entrepreneurs.

H4: Human capital as a mediating mechanism

Digital human capital mediates the relationship between AI-enabled smart-city development and FDI.

Multinational enterprises may be more likely to locate technology-intensive activities in cities where appropriate skills are available.

H5: Institutional quality as a moderating factor

Institutional quality strengthens the relationship between AI-enabled smart-city development and FDI.

The expected relationship should be stronger where investors face predictable regulation, effective governance, and appropriate digital institutions.

18. Methodological Approach for Future Empirical Research

The proposed framework can be tested using city-level or country-level panel data.

A city-level dataset could include measures of:

- FDI inflows;
- AI adoption;
- number of AI companies;
- AI-related patents;
- digital infrastructure;
- broadband penetration;
- digital human capital;
- innovation expenditure;
- university research;
- digital financial inclusion;
- institutional quality; and
- macroeconomic conditions.

A panel fixed-effects model could be used to account for unobserved characteristics that remain relatively constant within cities.

Where governments introduce smart-city or AI policies at different points in time, a difference-in-differences design could provide stronger evidence regarding causal effects.

As firms increasingly depend on data and algorithms, regulations concerning data protection, cybersecurity, cross-border data flows, intellectual property, and AI governance become part of the investment environment.

19. Developing Economies

The relationship between AI, smart cities, and FDI is particularly relevant to developing economies.

However, developing economies also face major constraints.

These include:

- shortages of advanced skills;
- limited digital infrastructure;
- unreliable electricity;
- restricted access to finance;
- institutional weaknesses;
- limited research capacity; and
- difficulties retaining skilled workers.

This approach has precedent in the existing literature. Ye et al. (2021) used a difference-in-differences model and data from 226 Chinese prefecture-level cities to examine the effects of smart-city construction on FDI quality. Directory of Open Access Journals

The more recent 2026 study uses panel data from 290 Chinese cities from 2012 to 2022 and a two-way fixed-effects model, together with robustness and endogeneity checks (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

Future research could extend this approach internationally by developing a city-level panel covering Asia, Europe, Africa, Latin America, and the Middle East.

20. Policy Implications

The relationship between AI-enabled smart cities and FDI has several implications for policymakers.

First, AI policy should not be developed separately from investment policy.

Governments should connect digital transformation with investment promotion, education, innovation, infrastructure, and industrial policy.

Second, investment in human capital is essential.

Advanced digital infrastructure has limited economic value if firms cannot find workers with the skills required to use it.

Third, cities should encourage relationships between multinational enterprises, domestic companies, universities, and research institutions.

These connections can increase the potential for knowledge transfer and local economic spillovers.

Fourth, regulatory frameworks should provide clarity around AI, data, cybersecurity, intellectual property, and digital services.

Fifth, policymakers should pay attention to the quality of FDI rather than focusing exclusively on the volume of investment.

Foreign projects that create skilled employment, research activity, technology transfer, supplier relationships, and local innovation may generate broader economic benefits.

Finally, AI strategies should be based on local comparative advantages.

Not every city needs to become a global AI hub.

A more realistic approach is to use AI to improve the sectors and capabilities that already make a city economically distinctive.

21. Discussion

The literature reviewed in this paper suggests that AI is becoming increasingly relevant to urban competitiveness and international investment.

However, the relationship is more complex than a simple claim that "more AI produces more FDI."

The evidence from China demonstrates that smart-city development can improve FDI quality (Ye et al., 2021). The more recent study of intelligent development finds that digital human capital, innovation, and digital financial inclusion are important mechanisms linking intelligent development to FDI (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

At the country level, Grigoriadi (2026) finds that newly funded AI firms are positively associated with investment flows in a sample of OECD countries. However, the study also finds that AI patent measures can have different effects, illustrating that technological activity does not automatically translate into investment attractiveness. Wiley Online Library

These findings point toward an important distinction between technological capacity and economic capability.

A city can possess AI technologies without having a strong AI economy.

For AI to influence FDI meaningfully, technological capabilities need to be connected to institutions, skills, innovation, infrastructure, and firms.

This is perhaps the most important conclusion emerging from the literature.

The economic value of AI is not determined simply by how much technology a city possesses, but by how effectively that technology is integrated into the city's economic ecosystem.

22. Limitations

This paper has several limitations.

First, a significant part of the available city-level empirical evidence comes from China. China's institutional environment, industrial policies, economic structure, and smart-city programs are different from those found in many other countries.

Therefore, the results should not automatically be generalized to all cities.

Second, AI is difficult to measure.

The number of AI companies, AI patents, AI researchers, AI investments, computing facilities, and AI adoption rates measure different dimensions of technological development.

Third, FDI is heterogeneous.

Investment in manufacturing, services, research and development, data centres, financial services, and natural resources can generate very different economic effects.

Fourth, causality remains an important challenge.

It is possible that cities attracting more FDI also have greater resources to invest in AI.

In other words, the relationship may operate in both directions:

AI development → FDI

but also:

FDI → AI development.

Future research therefore needs to address reverse causality and other sources of endogeneity carefully.

23. Future Research Agenda

Several areas deserve further investigation.

First, researchers should distinguish between different types of AI investment.

Data centres, AI research laboratories, AI-enabled manufacturing, financial technologies, and digital services may have very different effects on local economies.

Second, future research should examine whether AI attracts different types of FDI.

For example, technology-seeking FDI may respond differently to AI capabilities than market-seeking or resource-seeking investment.

Third, researchers should examine the role of human capital in greater detail.

The availability of skilled workers may determine whether AI infrastructure becomes economically productive.

Fourth, institutional quality deserves more attention.

Future studies could examine whether the effect of AI on FDI is stronger in cities with more predictable regulation and stronger governance.

Fifth, researchers should examine whether AI changes the importance of low labor costs.

The 2026 evidence from Chinese cities suggests that intelligent development can reduce the traditional advantage associated with low-cost labor (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

Finally, future research should move beyond investment attraction and examine long-term development effects.

The key question is not only whether a city attracts FDI, but whether that investment generates productivity, technology transfer, employment, entrepreneurship, and sustainable economic development.

24. Conclusion

Artificial intelligence is becoming an increasingly important part of the economic infrastructure of modern cities.

Its applications now extend across transportation, energy, finance, healthcare, manufacturing, logistics, public administration, and urban planning. At the same time, multinational enterprises are increasingly operating in an environment in which digital infrastructure, technological capabilities, innovation, and human capital influence international investment decisions.

This creates an important connection between AI-enabled smart cities and foreign direct investment.

The evidence reviewed in this paper suggests that smart-city and intelligent development can contribute to FDI attraction and quality, but the relationship should not be interpreted as automatic.

Ye et al. (2021) found that smart-city construction significantly improved the quality of FDI in Chinese pilot cities. Wiley Online Library

More recent evidence from 290 Chinese cities shows that intelligent development can attract FDI through digital human capital, regional innovation, and digital financial inclusion (*Does Intelligent Development Attract Foreign Direct Investment*, 2026). ScienceDirect

Evidence from OECD countries also indicates that newly funded AI firms are positively associated with investment flows, although the effects of other AI indicators are more complex (Grigoriadi, 2026). Wiley Online Library

The global investment environment reinforces the importance of these developments. UN Trade and Development reports that global FDI increased by 6% in 2025 to approximately US\$1.6 trillion, while AI-related digital infrastructure emerged as an important component of the investment recovery (UN Trade and Development, 2026). Investment Policy Hub+1

The central argument of this paper is therefore that AI should be understood as a potential source of urban location advantage, rather than as an independent or automatic determinant of FDI.

AI can make cities more attractive when it contributes to better infrastructure, stronger innovation systems, improved public services, skilled human capital, and more efficient business environments.

However, these benefits depend on complementary conditions.

Cities need reliable infrastructure, skilled people, effective institutions, predictable regulation, adequate energy supplies, and connections between foreign investors and domestic economic actors.

This means that the future competition for FDI may increasingly involve competition between urban ecosystems, rather than competition based solely on tax incentives, labor costs, or physical infrastructure.

For developing economies, this transformation presents both an opportunity and a risk. Cities that successfully combine AI with education, infrastructure, innovation, and effective governance may be able to attract new forms of international investment. At the same time, cities that lack these foundations may find it increasingly difficult to participate in AI-related global investment.

The most important question for future research is therefore not simply whether AI attracts FDI. The more useful question is:

Under what conditions does AI-enabled smart-city development attract productive, high-quality, and sustainable foreign direct investment?

Answering this question can contribute to international business research, urban economics, development economics, and the growing literature on smart cities and artificial intelligence.

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