Foreign Direct Investment

Introduction

Foreign Direct Investment (FDI) has its significant importance and plays a special role in the forms of international capital flows. FDI refers to the capital investment in an anticipation of gaining long term economic interest of the capital investment of a particular country. The foreign direct investment facilitates in providing control over an investor’s capital allocation. Therefore, the FDI takes into account the initial acquisition of all successive transactions among the enterprise and the investor and the investor’s foreign property. This essay will be emphasizing the significance of FDI and will be taking different aspects of foreign direct investment into consideration.

Foreign direct investment (FDI) has always been a controversial topic both in the host country as the investor, because, firstly FDI does not create jobs (or generates less) in the country of the issuer. Thus we see how labour organizations such as the U.S.; have been reluctant to expansion of multinational corporations. Moreover, in recipient countries political resistance has been largely fuelled perhaps by the presence of power that involves the parent company. The fact is that the multinational company is now a significant part of world trade has spread virtually worldwide, increasing its share in developing countries. It is a fact that FDI, in the hands of the multinational company, has expanded trade liberalization.

Foreign Investment and Global Changing Paradigms

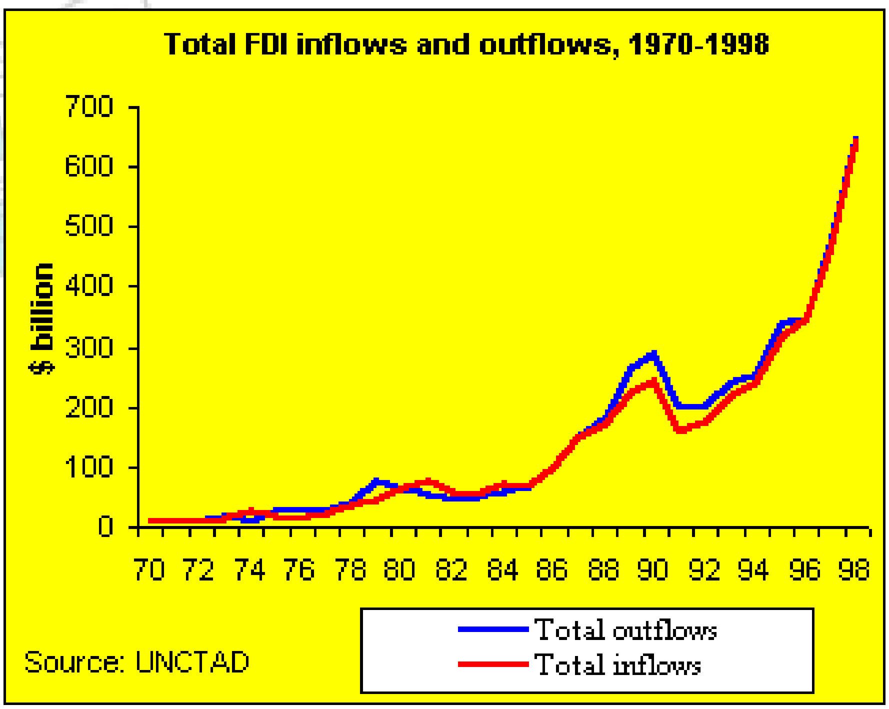
In the last 15 years have seen significant growth in the amount of international financial resources seeking to acquire a certain participation in the management, ownership or control of companies located in places outside their country of origin, better known as Investment Foreign Direct Investment (FDI). It is estimated that in 2006 the total foreign direct investment in the world was U.S. $ 1.230 billion S, of which 367.7 billion (30% of total) went to developing countries. While there are recent economic literature that mentions the positive aspects must be taken into account during a period of over twenty years, governments in many Latin American countries viewed with suspicion and distrust to FDI (Alfaro, 2003: p. 36).

In the 50's and 60's, structuralist economists held a doctrine which assigned a significant role to domestic industrialization as a means to promote economic development and achieve sustained increases in living standards of the population. In Latin America, this school of thought is expressed in a development strategy "in" based on import substitution industrialization (ISI), which operated through high tariffs, systems-tariff protection, multiple exchange rates and substantial public subsidies, a high degree of state intervention in the economy. Eventually, the widespread import substitution model resulted in an uncompetitive industrial structure and a marked anti-export bias, which usually followed a period of trade liberalization. A trade liberalization joined a series of structural reforms that included privatization, free entry of FDI, deregulation, financial liberalization, etc .These reforms, which respond mainly to Washington Consensus policies had its foundation in neoclassical theories that suggest that the best strategy for a small country is free trade, tariffs low and stable and participation in multilateral structures that guarantee a minimum distortions internationally. This change in perspective has given rise to amend the public policy approach towards FDI from developing countries, which have come to regard them as a source of financing Katheryn. This has led to a major debate on the merits and demerits linked with the fierce competition to attract FDI.

Discussion

Geographical Distribution and Scope of FDI

Foreign direct investment serves as the foundation of the rule of transnational corporations on the international markets. However, the significant and huge investors in the post-war era were the U.S. multinationals, whose main aim was to invest primarily in the emerging and developing countries. But from the beginning of 1970's the growth in the foreign direct investment turned to slow down and altered its focus. Most of the investments were intended towards the countries of Western Europe. Since the beginning of 1980's the foreign direct investment from Canada, Germany, Britain and the Netherlands were directed towards the United States, which eventually turns out to be the largest capital importer.



Globalization and FDI

The emergence of globalization gave a rise and encouraged the integration of distances and economies which were paralyzed exchanges among the states to combat. The modern ways of growth and financing were born along with the development of international financial flows. Now, all the developing economies and countries are competing hard in order to attract FDI's. The emergence of the term "globalization" has caused interest in the phenomenon of scientists working in almost all areas of science, politicians, public figures, businessmen and ordinary citizens of our planet. For the first time this term appeared in 1983 in an article in the Journal of T. Levitt, "Harvard Business Review". Initially under him understood formation of unified global markets, where there are large corporations that produce similar goods and services. At present there are a large number of definitions and the historical stages of this process, often in conflict with each other. Foreign direct investment contributes to the improvement of local companies because the increased level of investments through supernational companies can actually facilitate local companies through sub-contracting relationships (Petr H. & Petra O., 2001: pp.71: Para: 1).

The globalization of the world economy is a qualitatively new process of formation of a single world economic, financial, information, intellectual and humanitarian space, through a revolution in electronics, computer science and telecommunications, where the major players are the transnational corporations, transnational banks, supranational structures (such as the IMF, World Bank, WTO, etc.) and sovereign states, supporting and influencing the process. Significant role in the process of globalization is the international movement of capital, contributing to economic growth and the recipient countries and donor countries, and, consequently, financial globalization as a part of globalization of the world economy.

Globalization Consensus

Back in an era of 50’s and 60’s, foreign direct investments were regarded as distrust by several countries from the developing part of the world. FDI’s were taken as a factor which is dominant because of which multinational corporations were supposed to minimize the social welfare by influencing price transfers and the construction of economic enclaves. Particularly, it has been claimed by the Robert (2009: pp.143, Para :1), that during the time of 1980, most of the governments from all over the world has now taken into consideration the financial and trade liberalization, because of which the results are obtained almost the same as they were forecasted. The developing countries have gained rapid changes in their incomes and economy as compare to the developed countries. They have strengthened their economies in terms of their poverty reduction level, income and standard of living.

Determinants of Foreign Direct Investment

There are several different factors that force the overall flow of foreign direct investments in particular provided location, which can be a country, a region (Volker & Estrin,2004: pp. 530). Some of the factors which are also considered as the determinant of foreign direct investment are political, economic, and geographic strength, social and cultural impact on economy as well (Ajayi, 2006: pp.16, Para:1).

Motives for Determining the Foreign Direct Investment

The easiest way to make money on investing abroad reduces the purchase of financial assets in foreign companies, such as stocks and bonds. Next in simplicity is either conducting export operations with foreign firms or licensing of a foreign company. These options allows an investor to avoid the risks and costs associated with the movement of personnel in the foreign country, the difficulties caused by the necessity of conducting business in a foreign language as part of another culture, organization of supply, the development of new markets, operating in a different political climate and a host of other problems (Onyeiwu, 2003: pp. 89-106). However, most of the successful companies in the world are all in the interest of its investors, while experiencing the risks and carrying costs associated with foreign direct investment (Kuemmerle, 1999: pp. 1- 24). The following are some of the political, economic and competitive motives behind these decisions.

Political motives

Some of the most obvious reasons that determine FDI relate to the political sphere. Governments often believe that in the interests of their populations to prohibit or restrict access to the national market for goods and services from abroad. Despite the clear violation of the rights of the consumers to restrict their access to foreign goods, which may be of better quality and / or cheaper than domestic, governments often act out of conviction to protect national jobs from possible cuts or because of nationalist beliefs, or even out- for the feelings of xenophobia.

International business people, would stand to export their goods to a country, often find that they can penetrate the market closed to them by signing an agreement to work or at least partial production in that country. Sometimes these same methods triggered and to overcome the limitations that act as quotas, tariffs and import duties on imports. Production in another country in this case is not so much concerned authorities in matters of possible job losses and wounded national pride.

However, the political motives behind foreign direct investment are not always associated with overcoming barriers to trade. Sometimes political factors used by local authorities as an incentive. Parent companies located in countries with a high level of taxation, or where there are strong regulatory impact of its government, or there are some other factors that interfere with their work, can solve these problems by moving their operations to countries that provide more business favourable conditions. Truly multinational business usually suffers less from the adverse political action, since local governments are limited in their capacity decisions of companies to move their operations to another location that results in the loss of jobs in this country, the income received from the company, and often reputation.

Economic motives

Economic factors may also affect foreign direct investment. Companies adhering to this strategy can realize significant economies of scale of operations, particularly in the areas of applications, such as research and development, marketing and distribution of goods and services, financing, production, operating with the volumes that can be achieved by working only on a global scale.

In addition to the economies of scale offered by the multinational operations, the company may, in this case more easily cope with the problems of sabotage and lack of certain factors of production at any local markets. Perhaps among the indigenous population of the country is not enough technicians and engineers the necessary qualifications, or are missing any components of raw materials, or they are too expensive. Production capacities of multinational companies are doing all the factors of production available at most reasonable prices. A multinational corporation that manufactures and sells its products in many countries can take advantage of fluctuations in real exchange rates. When the exchange rate higher prices, adjusted, adjusted for inflation, in one country and drop them in another company can increase production to countries with lower costs and sell them in the country with higher prices.

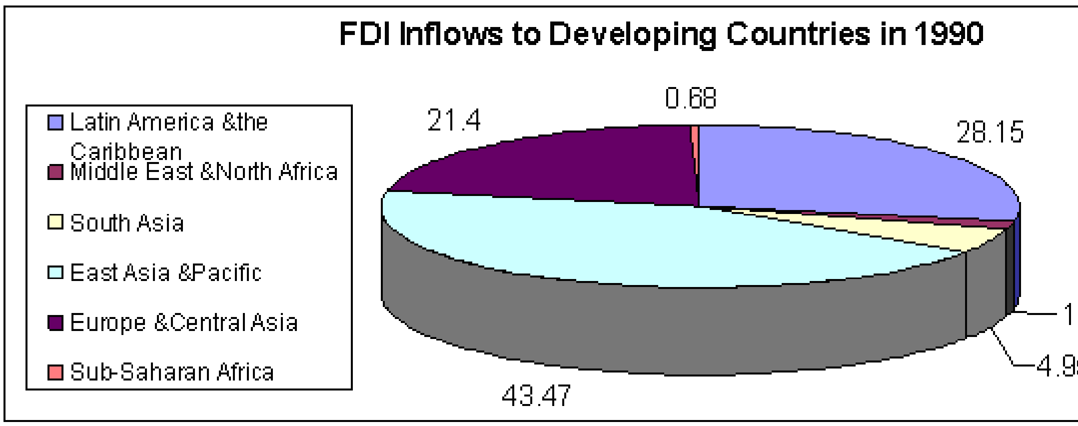
Competitive motives

For competitive reasons, determining foreign direct investment, are closely related to economic and political factors and are often indistinguishable from them a little. The company may invest directly abroad in cases where clear economic and / or political advantage is not obvious. The reason for the decision is usually due to the fact to protect against actual or potential competition. For example, companies are willing to make a section of the international market or product, even if it looks profitable, as is the case for dumping or export of products at prices below cost. The purpose of such action is often the ruin of the actual or potential competitor. When the division of markets occurred, production costs are reduced or increased prices. In many cases, it is illegal dumping technique for the application of which penalties are imposed and paid compensation to companies who have suffered from a loss.

It happens that the company to accelerate the development of certain sectors of national industry, which does not exist, lobbying in favour of the establishment of protectionist barriers against foreign competitors. Another example of foreign direct investment, backed by competitive reasons, is to merge with a foreign company or its absorption, which is done in order to gain access to foreign technology. Sometimes investments in foreign operations are done, and the objectives of entering foreign markets, or for manufacturing expertise. Many governments, however, have established barriers to such acquisitions.

Trade and Investment Liberalization

According to Patrick(2008: pp. 5, Para: 2) since the last two decades, liberalization in the trade policy in Africa has resulted in approximately $272 billion as discussed by Christian Aid (2005) and Kraev (2005). There has also been a price issue in Africa, which has resulted due to reliance on main commodities. This has made the trade worse in the Northern subsidies along with fall in prices in the long-run for a number of exports, causing producers in Africa into a pricing issue. Producers find themselves into problems when they increase the output, but have diminishing revenues (Burnett & Manji, 2007: pp. 142).

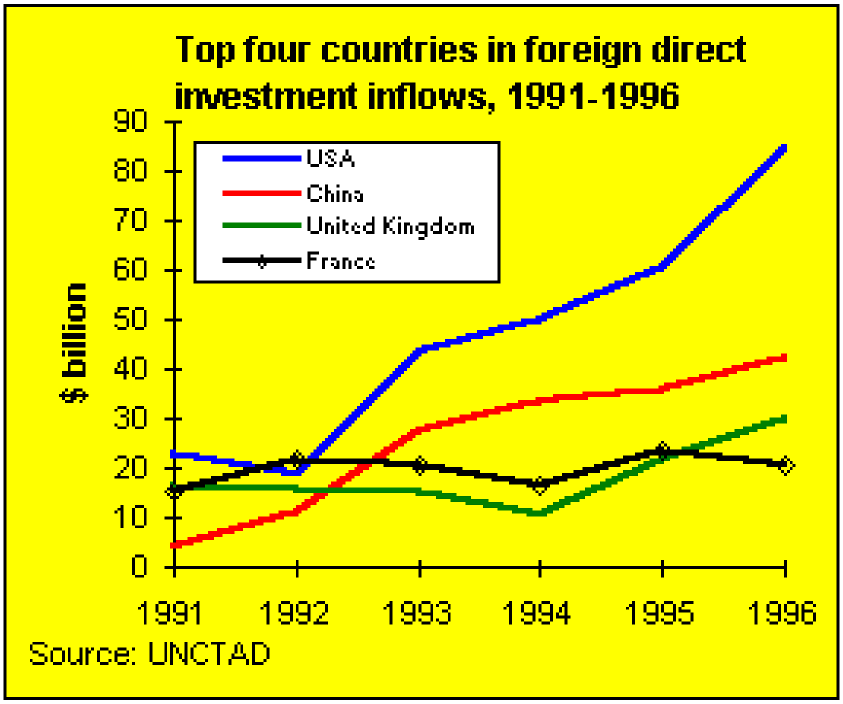


Foreign exporting firms often go to the establishment of strategic alliances with local manufacturers, giving them access to the world market. Thus, foreign direct investment through multiple channels can contribute to the improvement of production and social infrastructure, and the balance of payments of the recipient country. They increase the volume and improve the structure of domestic capital accumulation, accelerate the pace, increase its rate (the ratio of the mass of profit used for the accumulation of capital, the total weight of profit as a result of economic activity) in the country - importer of capital. In addition, it is also important that foreign investment ascribe local entities to market behaviour. As for Africa, positive impact of FDI on the economy is still the exception rather than the rule. Foreign presence can also have a negative impact on the reproductive process in the recipient country. Thus, the investments of foreign companies are the source of additional funds to finance domestic investment only for as long as the repatriation of profits do not exceed the investment.

Foreign direct investment can also be used inappropriately by the regime of countries, which may result in increasing foreign debt and repayment issues. In the case of Africa, the debt ratios have been burdensome, which resulted due to loans given to dictators. Till the year 2000, there more than 20 countries that found it difficult to repay the debt. This surpassed the level of foreign earnings by more than 300 percent. Countries such as Sudan, Burundi, Sierra Leone and Guinea-Bissau experienced increased level of debt by more than 10 times that of export earnings in the year. However, there is no surprise that such nations also experienced extreme conflicts. It was noted that the initiative taken by the Highly Indebted Poor Countries also did not succeed to bring positive changes in the debt servicing ratios. This was also noticed by the World Bank officials (Bond & Brutus, 2005: pp. 3-7). On the other hand, initiatives such as the small debt relief concessions, which also included the offer by finance ministers in the June 2005 G7 summit resulted in strict neoliberal conditionality (Patrick, 2008: pp. 4, Para: 3).

Eclectic Paradigm-Productivity and Local Affiliates

It is seen that manufacturing companies in the international market may perform more than the local competitors. It is probably due to the effect of specific ownership that may result in the difference of productivity due to the difference in intangible assets, which have been transferred from the parent organization. However, it may also be the result of the characteristics of economy of the company performing in the international market. This is also known as the location specific component of any productivity differential (Dunning, 2001: pp.174, Para: 1). Direct investments often do not lead to improvement in the structure of production and accumulation in the host country, as foreign firms, guided the theory of product life cycle, transfer abroad mainly the technologies and the equipment, which they lost their status as the newest country. In China and much of Eastern Europe, for example, companies with foreign participation have benefits (reduced rates for domestic services and the rental of space, better access to raw materials, tax, customs and other benefits) only in exchange for the delivery of the latest technologies and techniques. UK also provides the largest foreign investors preferential treatment of management, without burdening them this requirement. And because there are cases reset to UK obsolete equipment for the production of yesterday's models, as well as equipment for the production, restrained foreign government restrictions (e.g., tobacco, household chemical products in plastic containers, etc.). It was reported that American concern "Monsanto" unfolded in UK production of mutant is an immediate risk to public health and prohibited for import of most developed and developing countries.



With the increasing complexity of production and higher level of vertical integration in the multinational companies weaken their contacts with local subcontractors. The emergence of "compartments" controlled from abroad and weakly connected to the national economy does not create conditions for the development of conjugate production in UK. And because the equipment, components and spare parts are available for intra-channels from abroad, and the additional demand for labour does not occur in the country operate, and in the country of the parent TNCs. This increases the differences in socio-economic development of certain regions of the recipient country, increasing fragmentation of its economy, destroyed its single economic space. Reducing the number of employees in enterprises with foreign investment and is fraught with constant danger of repatriation capital imported and the phase-influenced deterioration of the investment climate, economic crisis, or any other circumstances.

Eclectic paradigm of John Dunning will be very useful to apply in order to achieve many practical purposes to attracting FDI. L-assessment of their benefits (the nature and range of local factors and markets), and a comparative analysis with the fact that there are competitors of the recipient countries of FDI, and the study of O-advantages (the nature and range of competitive advantages for foreign investors) and I-advantages (maximum possible degree of internalization of companies) potential foreign investors will to work more effectively in search of foreign investors better able to negotiate with them and convince them of the benefits of investing in this particular country(John, 2000: pp.21, Para: 1). Furthermore, the analysis of its L-advantage once again remind the politicians of the shortcomings in this area, which will lead to the use of appropriate measures to address them: increased L-advantages in the economic, political and legal spheres (Dunning, 2000: pp. 119- 139).

Theory of Foreign Direct Investment

Economic transition has a number of specific characteristics that distinguish it from an economy in a relatively stable and growing on its own basis, by improving its inherent institutions, connections and relationships. Economic transition is qualitatively new way of organizational and economic structures and their corresponding relations, replacing the old. The result is a new macro and micro-economic patterns and trends, triggered by social and political changes, determined the corresponding goals and objectives of economic policy (Volker, 2004: pp.530, Para: 1).

Conclusion

In Western literature transition economy is generally understood as a system in which the transition from a command type of socio-economic processes to the market. In countries with economies in transition for the effective completion of the restructuring of the market, ensuring sustained high rates of economic growth and effective integration into the global economy, it is extremely important to attract foreign direct investment (FDI). Without FDI is difficult to complete the transition process at a relatively low volume of domestic resources. At the same time, competition in attracting FDI is now becoming more stringent. Therefore the transition, which is so important for FDI, should improve the investment climate, especially with regard to the formation of an efficient and effective investment policy (Katheryn, 2002: pp.15, Para: 1).

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