

Micro and macroeconomic theories of fdi



**ASSIGN
BUSTER**

Compare and contrast the main micro and macroeconomic theories of foreign direct investment. Referring to your home country appraise which of these theories most accurately explains the pattern of foreign direct investment in recent years.

ABSTRACT

With the readings and research done, I conclude that there is a need for agreement with the theoretical sphere of cross national readings. The theoretical focus of such intellectual behaviors has managed to mirror the multidisciplinary character of the subject. As for now, the most considerable contributions to the knowhow of the subject can be matched to the global economics, in the global finance and the global business literatures. The increase in focuses and the range of experimental studies that are to be found in these literatures, shows the treasure of knowledge which may be credited to the investigation of inter-national business related actions and processes attempts to explain many of the prevailing theories amongst these literatures mentioned. Offerings to the macro level of study can be established in the structure of the theories of global trade. On the other hand, the theories relating to the micro economics take on the business as the degree of investigation and thought is given to both the FDI decision process and the way it is pursued by companies in internationalization all over the world.

Based on the various theories that have been presented along the essay, I have done an analysis on what route India has approached in order to successfully attract FDI even though its trade restrictions were quite severe and not 100% of FDI was allowed in most of the areas.

MACRO ECONOMICS AND MICROECONOMICS

The word has been derived from the Greek prefix “ micro “ which means “ small” & “ economics” is the branch that evaluates how the sole sections of the economy, which may be the domestic and the firms, make decisions to assign restricted resources, typically in markets where goods or services are that are being bought and sold. Microeconomics examines how these decisions and behaviors affect the demand and the supply for commodities and services, which examines prices, and how prices, consecutively, decide the demand and supply of commodities and services. The microeconomic theories measured focus principally on technology seeking companies as the opportunity cost of not internalizing awareness is most here.

This is in dissimilarity to the macroeconomic theory that involves the sum of economic activity, handling the issues of growth, inflation, and unemployment. Also, Microeconomic theory handles the effects of state run economic policies such as changing levels of taxation on the above mentioned aspects of the economy. Predominantly, while considering Lucas critique, much of modern Macroeconomic theory has been built upon micro foundations which are based upon basic assumptions about microeconomic level conduct.

Source: Google images

This demand and supply diagram demonstrates how prices differ as an outcome of equilibrium amongst product accessibility at each given price which is known as supply and the requirements of the ones with buying power at each given price is called demand. This graph shows a transfer in

demand from point D1 to point D2 together with the resultant growth in cost and number required to attain a new point of market equilibrium position on this curve of supply which is S.

One of the aims of the theories in microeconomics is that to evaluate market mechanisms which set up the relating pricing amid commodities and services and distribution of the resources that are limited amid many substitute uses. The microeconomic theory figures out any kind of failure in the markets where competent results are unsuccessful to fabricate by markets, and it also tells us about the hypothetical environment required for a competition that is perfect. Within the noteworthy areas of learning in the microeconomic theory included are broad balance, the markets in asymmetric information, preference within ambiguity and economic utility of Game Theory. The other thing which is considered in the market system is Elasticity.

THEORIES IN FDI

DUNNINGS ECLECTIC PARADIGM

The OLI paradigm contributes in such a way that it gives a structure for the debate of the intentions of FDI.

Dunning (1977, 1981), efficiently summarizes the micro and macro economic theories and further clarification in his popularly known “ ECLECTIC PARADIGM” or the OLI rationalization of the theory of FDI.

For a company to effectively invest in a foreign country, it should have advantages that no other company owns: also called Ownership. The country

in which it desires to invest should present location advantages: also called Location. Also, it should be competent of internalizing operations: also called Internalization.

VERNON'S THEORY: PRODUCT LIFE CYCLE

In the 1960's Vernon (1966) put in the thought of the product life cycle into the international trade so as to elucidate the subsistence of overseas production as well as trade. Vernon suggested that, the distinctiveness of the produce changes as the produce goes along the PRODUCT LIFE CYCLE.

We may consider Vernon's input as an important and informative factor in FDI as had explained a few of the outflows of Foreign Direct Investment in the US during the 50's and 60's. This theory at the time was also considered to be of great importance as it looked at trade and direct investing as being the vibrant option to provide the demand in the foreign boundaries.

HYMER'S THEORY

Theory of International Operations, proposed by Hymer (1960) set the early stage of modern theories on Foreign Direct Investment. His theory tells us why companies decide to go global and not just export their products into other markets. His first argument was that prospective FDI companies desired to remove conflicts. He also argued that if one company controlled all the other enterprises rather than separate firms operating, it would yield better and quantitative results. Hymer also argued that a few manufacturers benefitted from a company specific benefit over local firms. The theory lastly

argued that the credit that earnings in one business are over and over again inversely correlated with profits in another business.

Internalization Theory

The theory of internalization is related to Buckley and Casson (1985). They wanted to enlighten how transnational companies organize their business in international markets for in-between products which include labor possessions and other reserve inputs. Buckley and Casson (1985) argued that companies could cut down on transaction and manufacturing costs by internalizing the market for marketing and management resources, from which maximum profit could be extracted.

Kojima (1984).

Kojima (1984) argues that FDI will arise in the source nation's comparatively disadvantaged (or marginal) industry, which is potentially comparatively advantaged in the recipient nation. The host country has the prospect to decrease its relative disadvantage as Kojima's theory on FDI states.

Taking India as a means to analyze the two theories

THE MACRO – ECONOMIC ENVIRONMENT:

As we know, macroeconomic theory deals with the cumulative presentation of the economy; it also takes into consideration the broad concepts like the national income, gross domestic product and growth rate of the economy, unemployment changes, inflation rates and price variations. When these factors are analyzed, the overall situation of a country's economy is exposed. Macroeconomic theories are indeed a complex and complicated means of

analyzing as compared to the microeconomic theories as we know that micro economic theories take more into consideration the individual and how they may influence economic decisions. I have also understood that the studies relating to macroeconomic theories sufficiently help the customers, businesses and economic decisions that Indian government would have to take.

When a micro and macro analysis was made on the trade in India, with the help of the Eclectic model by Dunning, I could analyze that international companies were looking to productively benefit from India's remarkable growth need to recognize numerous driving attributes like a strong and diverse culture, its distribution of population, the local environment and the risks that are indeed unique to India.

STABILITY OF INFLATION IN INDIA:

Political ups and downs and natural disasters undermine a very significant fraction of real time mindshare and energy of the government of India.

The sustained sturdy domestic expenditure, induced by growing incomes and a rising middle class, are now the key force in the growth of India. The savings rate have gone up and also the level of investment have had a major source in supporting the continued economic acceleration of India which proves that macroeconomic steadiness and the essential infrastructure are amongst the pre necessities for continued development. Indian inflation has by and large been kept under strict vigilance. In spite of the high inflation from 1980, price rise has been balanced by a variety of financial, monetary and governmental procedures.

In order to promote growth and keep inflation at a lower level, the government of India decided to control their budget deficits.

M. Bhramabhatt et. al. (1996) in his learning outcome has recognized four key discrepancies in India's capacity and capability to incorporate with the economy of the world. These are namely, deficient macroeconomic policies present, comparatively high intensity of protection present, incompetent communication and transportation infrastructure and badly operational and nonflexible labor markets present. M. Bhramabhatt et. al. (1996), in addition, expressed disagreement, that these weak points may dissuade Indian companies and the investors in FDI from concentrating on the export markets in India.

By using the shares of both the countries in global and low and middle income countries' GDP of 2004 respectively as weights

The share of India in global and low income countries' GDP respectively, have increased over the period of time. The Indian share of the GDP amongst the low and middle countries is obviously elevated than in global GDP and the input to GDP growth in low and middle income countries is much elevated.

Today, FDI is completely permitted in various segments with the automatic approval prevailing, the freedom of locality and preference in technology that prevails. There was an aim that the government of India had to attain – attracting foreign direct investment. This was done by the help of setting up specified economic zones, various science parks and free trading and warehousing zones were made available to enhance the FDI in India.

To summarize, the government of India took certain actions to hype up the FDI inflows in the country.

Industrial licensing, other than a few strategic sectors, was abolished.

Under the automatic routes, FDI was allowed up to a 100%.

The Indian currency, RUPEE, could now be fully converted.

There were reforms in the financial sectors of the government and there was a decontrol of rate of interests.

The quantitative limitations on imports were abolished.

Fig: Given below are the approval routes of FDI in India

AUTOMATIC ROUTE

APPROVAL BY FOREIGN INVESTMENT PROMOTION BOARD

Is to be followed by giving powers laid down by Reserve Bank of India.

FIPB studies the proposal, a study is then made and a decision is given within a month from the date of submission.

Up to a 100% of FDI allowed to the companies that were upcoming and the ones that were existing. Only the ones that required prior approved by the Foreign Investment Promotion Board were not allowed 100% FDI.

Industries handling project with higher priority will be given preference.

All this is done under the supervision of FIPB

Approval is needed for projects not qualifying for automatic approval.