

Negative effects of fdi in host countries economics essay

Countries



In last decennaries the importance of Foreign Direct Investments (FDI) has increased significantly due to globalisation procedure, which offers immense chances for largely developing states to make faster economic growing through trade and investing. FDI assists foreign investors in using their assets and resources more expeditiously every bit good as host states in acquisition of better engineerings and acquiring involved in international production and trade webs (Athukorala, 2003) .

Developing states have started to see FDI as a beginning of economic development and modernization, income growing and employment. These states have liberalised their investing governments and followed other policies to pull more FDI. They have attempted to happen the ways of prosecuting those domestic policies that will let them to drive maximal benefits from transnational endeavor presence in the domestic economic system (OECD, 2002) .

The purpose of this survey is to analyse the impact of FDI on the economic system of host states. The first portion of the work will be addressed to the relationship between foreign investings and the economic growing of the host states. The survey will reply the inquiry why some states benefit from FDI more than other states, and what these authoritiess should recognize in order to maximise their benefits from the presence of foreign houses.

The undermentioned parts will be devoted to more certain issues, such as positive and negative effects of FDI in the host states. Since there is a wide literature on the positive impacts of foreign investings, the chief focal point in this work is emphasized on the negative impacts. The survey shows that

although MNEs bring many benefits to host states and the authorities are seeking to pull more and more investments, the negative effects of FDI in the economic system of host states should not be neglected. Any indifference to these issues may ensue in negative spillover effects, balance of payment shortages, double economic system, pollution and etc.

Brief information about the negative impacts of FDI, particularly, Dutch Disease effects, on the economic system of Azerbaijan is besides given at the terminal of the survey in order to convey a practical illustration. This portion is besides provided with charts for more ocular description of the effects.

FDI and Economic Growth

Global economic events of past decennaries driven by technological advancements, regional integrating and realignment of economic policies and systems have changed the perceptual experience of host state authorities of how FDI can lend to their economic and societal intents. They became more interested in the function of FDI in their states to understand its benefits and costs, and to uncover what should be done by national disposals to see that benefits of FDI influxes to their economic and societal demands will be maximized (Dunning, 1995) .

Theory on FDI and growing relationship

In theory there are contradictory positions about the growing effects of FDI. The chief principle behind the particular inducements to pull FDI is the belief that they produce outwardness in the signifier of engineering transportations and spillovers (Carkovic and Levine, 2002) . Romer (1993)

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argues that FDI can ease the transportation of technological and concern know-how to less developed states and heighten the productiveness of all houses in the host state.

However, some theories province that foreign investings will damage resource allotment and decelerate the economic growing due to merchandise, monetary value, fiscal and other deformations in less developed states (Boyd and Smith, 1992) . Despite these contradictory theories, some theoretical accounts suggest that FDI will advance the economic development under peculiar policy conditions (Carkovic and Levine, 2002) .

Factors of FDI influence

The extent to which the foreign investing can lend to the economic growing depends on a assortment of factors. One of them is the host state features, called `` absorbent capacity " , - a capableness of the host economic system to profit from technological spillovers from the more industrialised states and the ability to roll up and best utilize engineering and cognition (Narula and Portelli, 2005) . The chief determiner of the `` absorbent capacity " is the quality of establishments, peculiarly, the regulation of jurisprudence and the belongings rights protection.

Trade openness, which is a step of the competition degree in the local state, besides positively influences the degree of FDI part to growing. States with more unfastened trade policy have less market deformations, high degree of efficiency and competition which enhance the spillover effects of FDI

(Balasubramanyam et al. , 1996) . A trial between FDI and end product

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growing in 24 states in 1971-1985 old ages conducted by Nair-Reichert and Weinhold (2001) besides reveals that the grade of state 's trade openness had a immense impact on the efficiency of FDI in the host state.

The degree of technological edification and human capital stock in the host state is besides one of the chief factors of FDI impact on growing. It has been found that FDI raised the growing in those states that reached a minimal threshold degree of technological edification or the stock of human capital (Borensztein et al. , 1998 ; Xu, 2000) The engineering spread between MNE and domestic houses in the host states is the chief property for the outgrowth of engineering spillovers. A high engineering spread along with a low competition reduces the spillover effects to the host state (Kokko et al, 1996) .

Other determiners include economic power, industry, type of FDI, and regional integrating, industry specialisation, market size, R & A ; D, geographical location, FDI policy of host state and etc (OECD, 2002) .

Maximization of FDI benefits

In order to harvest the benefits of FDI authoritiess of host states need to implement some policies, such as betterments of the general macroeconomic and institutional models ; creative activity of a regulativeenvironmentthat is contributing to FDI influxs ; and upgrading of substructure, engineering and human competencies to the degree where the full possible benefits of foreign corporate presence can be gained (OECD, 2002) .

International co-operation might help and reenforce the investment-related attempts of host states since the policy actions recommended above can non easy be pursued by authoritiess - particularly by hapless states - moving entirely (OECD, 2002) .

Foreign investors play a important function in engendering economic growing and lending to accomplishment of sustainable development ends. Consequently, the manner MNEs behave and are ruled is of import in maximization of the FDI benefits for economic development. Foreign affiliates must heighten engineering transportation, better human capital direction patterns, and supply transparence and competition. They should besides forbear from seeking freedoms from national environmental, labour and wellness criterions (OECD, 2002) .

Positive effects of FDI

Trade effects

FDI influences economic growing by increasing entire factor productiveness and the efficiency of resource usage in the host state. It increases the capital stock of the host state and therefore raises the end product degrees. The chief trade-related benefit of FDI is that it contributes to the integrating of host states into the planetary economic system by breeding and hiking foreign trade flows every bit good as the constitution of multinational distribution webs. This, in bend, implies that host states will prosecute a policy of openness to international trade to profit from FDI (OECD, 2002) .

Human capital part

FDI 's part to human capital in host states is important. MNEs addition workplaces, thereby cut down the unemployment in the host state. They normally provide higher rewards and working conditions due to their higher productiveness which is explained by greater technological know-how and modern direction accomplishments that enables them to vie efficaciously in foreign markets. The transportation of technological and managerial know-how through affiliates besides gives rise to direct benefits and increases fight in host states. For illustration, domestic employees can travel from foreign to domestic houses. Local houses might increase their productiveness through larning from foreign houses by coaction. (OECD, 2008) . The presence of MNEs may besides do a utile presentation consequence, coercing the authorities to put in instruction more, as the demand for skilled labor by these houses is really high (OECD, 2002) .

Spillover effects

MNE 's normally possess a higher degree of engineering, particularly `` clean '' , which is the chief factor of their higher productiveness. One of the positive effects of FDI is that it generates important technological spillovers in the host states. MNE 's normally provide proficient aid, preparation and other information to increase the quality of the providers ' merchandises (OECD, 2002) .

Local houses might increase their productiveness as a consequence of deriving entree to modern, improved, or cheaper intermediate inputs produced by MNE in upstream sectors. Gross saless of these inputs by MNE

might be accompanied by provision of complementary services which might not be available through imports (Javorcik, 2004) . Local sub-contractors can besides profit from MNE 's international contacts, therefore deriving more entree to foreign markets. FDI can besides increase research and development enterprises of local companies (Tormenting, 1995) .

Competition degree

FDI exerts a important influence on the competition degree in the host state. The presence of MNEs assists the economic development by exciting the domestic competition and thereby taking to higher productiveness, invention, lower monetary values and more efficient resource allotment (OECD, 2002) .

Management and administration practises

FDI through acquisition of local houses result in the alterations in direction and corporate administration. MNEs by and large impose their ain company policies, internal coverage systems and rules of information revelation. This consequence improves the concern environment and develops the corporate efficiency. Furthermore, different instances show that foreign investings besides create a more crystalline environment in the host state as MNEs encourage more unfastened authorities policy, raise corporate transperence and aid in the battle against corruptness. (OECD, 2002) .

Since foreign investings supply needful resources to developing states such as capital, engineering, managerial accomplishments, entrepreneurial ability, trade names, and entree to markets, they are of import for these economic systems to industrialise, develop, and make occupations cut downing the

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poorness degree in their states. Therefore, most developing economic systems recognize the possible value of investments and have liberalized their investing governments and conducted investing publicity activities to pull FDI from developed states (Athukorala, 2003) .

Negative effects of FDI

Herding out consequence of FDI

FDI can hold both herding in and herding out effects in host state economic system. The chief negative consequence of herding out consequence is the monopoly power over the market gained by MNEs. Empirical grounds in that respect is assorted. Econometric trial by Agosin and Mayer (2000) covering 39 states for a long period (1970-1996) demonstrated that herding out and herding in was detected in 10 economic systems, but in 19 the consequence was impersonal. Herding out consequence did not be in Asia, but it was rather obvious in Latin America. Another survey of 83 economic systems over the period of 1980-1999 found no impact of FDI on host state for 31, herding out for 29 and herding in for 23 states (Kumar and Pradhan, 2002) .

This diverseness might be due to the fact that assorted economic systems attract different types of FDI. Countries that pull largely domestic market-seeking investments will see herding out as the constitution of foreign subordinates consequences in tough competition with domestic houses. But for export-oriented investing, it might be less so (Bhalla and Ramu, 2005) .

MNE with lower marginal costs increases production relation to its domestic rival, when a miss competency houses of the host state face fixed costs of

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production. In this environment, foreign houses that produce for the domestic market draw demand from local houses, doing them to cut down the production. The productiveness of local houses falls as their fixed costs are spread over a smaller market which forces them to endorse up their mean cost curves. When the productiveness lessening from this demand consequence is big plenty, entire domestic productiveness can decrease even if the MNE transportations engineering or its firm-specific plus to local houses (Aitken and Harrison, 1999) .

In general, herding out might take topographic point due to two grounds: 1) when domestic houses disappear because of higher efficiency and better merchandise quality of foreign subordinates, and 2) when they are wiped out because these foreign affiliates have better entree to fiscal resources and/or engage in anticompetitive patterns. In the first instance, the net impact on public assistance is positive as houses with higher efficiency and better merchandise quality contribute to the economic development of the host state. But in the 2nd instance, there is welfare loss and authorities intervene through different channels in order to assist the local houses. For illustration, they might set up or subsidise funding for domestic little and average houses (Bhalla and Ramu, 2005) .

Negative pay spillovers

Wage spillovers of the FDI are considered to be largely positive as workers of MNEs can go forth their workplace and go enterprisers in hereafter, which will increase the fight of domestic houses. However, it might do negative effects every bit good, particularly, if MNEs hire the best workers due to their

high rewards and thereby go forth lower-quality workers at the domestic houses (Lipsey and Sjöholm, 2004) . In response to that domestic houses can increase or copy MNEs ' rewards unnaturally to forestall their high-quality employees from altering the workplace in favor of foreign houses. But this action can take to competitiveness lessening of them as MNEs have productiveness advantages over the domestic houses.

Gorg and Greenaway (2001) reviewed six surveys on pay spillovers and reported that three panel surveys of those surveys found negative spillovers, while two cross-sections studied showed positive 1s. One possible ground of the negative consequences in some underdeveloped states is that the spread between MNE and domestic houses is really big for one party to act upon another. Furthermore, the labor markets in some underdeveloped economic systems are excessively segmented for rewards in one party to act upon another (Lipsey and Sjöholm, 2004) .

Net income repatriation

When MNEs make investments in foreign states their chief aim is to maximise their net income. Some advantageous features of these states, such as inexpensive labor force, natural resource copiousness or high quality expertness, let MNEs to heighten their economic public presentation. MNEs on a regular basis repatriate their net incomes from investing to the history of their parent companies in the signifier of dividends or royalties transferred to stockholders every bit good as the simple transportation of accumulated net incomes. It besides helps them avoid larger revenue enhancements by utilizing transportation monetary values. However, this net income

repatriation consequences in immense capital escapes from the host state to the place state and negatively affects the balance of payment of the former. Thus the host states frequently set bounds on the sum of net incomes that MNEs can repatriate in order not to hold balance of payment shortages or reduced foreign exchange militias. Such policy can bring on these MNEs to put net incomes in different undertakings within the host state (Billet, 1991) .

But there is besides a possibility that such restrictions might deter MNEs from putting in these states, which will travel FDI to the states with less net income repatriation restrictions. For illustration, a study of main executive officers from 193 American MNEs revealed that about 70 % of them viewed net income repatriation as a chief factor positively actuating the FDI behavior of them (Kobrin et al) . One of the biggest FDI receiving systems in the universe, India, permits 100 % net income repatriation for foreign investors in most sectors (NRI Repatriation) .

Double economic system consequence

FDI, particularly, made in the underdeveloped states can take them to hold a double economic system, which has one developed sector largely owned by foreign houses and developing sector owned by domestic houses. Since the state 's economic system becomes excessively dependent on the developed sector, its economic construction alterations. Often this developed sector is the capital-intensive, while another one is labor-intensive. Therefore, double economic system consequence hampers the economic development of states as most of their citizens are located in the non-developed labor-

intensive sector. This consequence is seeable in most oil-rich states, where foreign investings made in the oil and gas sector resulted in the resource roar and left the agribusiness and fabrication sectors underdeveloped. That negative consequence of FDI can take to Dutch Disease consequence in natural resource copiousness states.

Dutch Disease theoretical account postulates that a resource roar, largely after the immense investings in the sector, diverts state 's resources off from activities that are more contributing to growing in long tally. First symptom of this phenomenon is an grasp of the state 's exchange rate caused by resource roar, which in bend causes a contraction in the fabrication exports (Bulte et al, 2003) . The flourishing resource sector draws capital and labours off from fabrication, taking its costs to lift (Neary and new wave Wijnbergen, 1986) . The consequence is that the fight of state 's non-tradable trade goods rise, while that of tradable - fabrication trade goods falls in the universe markets, cut downing the possible for export-led growing of industries in the long tally. Since fabrication sector is regarded as the chief `` engine of growing '' , its diminution causes accordingly a growing diminution in state 's economic system in the long tally (Sachs and Warner, 1999) . One possible solution to the job is a variegation of the economic system by puting in different sectors.

Balance of payment consequence

Empirical surveies reveal that a bidirectional relationship exists between foreign investings and imports. An addition in FDI influxs from the place state will ensue in an addition in imports in the host state from the place state. It

can be due the fact that the MNE purchases inputs from its traditional providers or increased rising prices rate speeded up by foreign capitals in the place state. As more investing flows in, the host state economic system becomes more and more dependent on the production engineering of MNE 's place state. The host state will hold to import more inputs and intermediate goods from the MNE 's place state, which might restrain the development in the domestic industry. If these investings are non export-oriented, the host state can endure from trade shortages (Chaisrisawatsuk S. and Chaisrisawatsuk W, 2007) .

Infrastructure development restraint

FDI constrains basic substructure development by deviating resources from public investing in substructure. Since FDI is attracted largely to wealthy parts of the host state, the substructure in these parts will necessitate a greater attempt to be improved, particularly striping the poorer parts and the rural parts (Yamin and Sinkovics, 2009) .

Environmental issues

A big volume of FDI is concentrated in natural resource sectors of developing and less developed states. Most of these states have a less rigorous or non-existent regulative government. Sometimes states intentionally attempt to relieve or loosen their regulative demands to pull FDI. However, while these states can profit from positive effects of investing, the negative effects of FDI on host state 's ecosystems and environment might convey catastrophe in the long tally (Gray, 2002) .

The solution to these jobs is to raise host state capacity to modulate and build international environmental criterions. NGO 's and other civil society groups from place and host states can besides play a important function in the betterment of authorities ordinances and addition of MNE 's duty on environmental issues (Mabey and McNally, 1998) .

Other possible negative impacts

FDI can do political, societal and cultural agitation and divisiveness in the host states by debut of unaccepChart values, which includeadvertisement, concern imposts, labour patterns and etc, and by direct intervention of the MNEs in the political government or electoral procedure in the host state (Dunning, 1995) . For illustration, some least developed states with the economic system excessively dependent on powerful transnational endeavors are threatened of fring political sovereignty (OECD, 2002) .

Case Study: Dutch Disease effects in Azerbaijan

Azerbaijan had had a reasonably developing economic system with a consistent one-year GDP growing above 10 % until 2005. However, after a big sum of FDI 's in energy sector, the economic state of affairs critically changed and grew significantly in 2005-2009 old ages due (Chart 1. GDP of Azerbaijan. Chart 2. GDP growing) . Its oil and gas grossss fuelled the economic system and promoted a rapid rise in life criterions. But despite this prosperity, some negative impacts of huge foreign investings, particularly, Dutch Disease effects, became seeable over clip.

Large capital influxs and grossss shortly demonstrated its impact on high rising prices degree (Chart 3. Inflation rate) and the national currency of

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Azerbaijan - AZN has appreciated against USD Dollar and Pound Sterling, while its value against Euro has been volatile during 2006-2010 old ages (Chart 4. Currency Exchange) . As exports increased, the state started to run balance of payment excess (Chart 5. Balance of Payment) .

The fight of non-tradable trade goods have risen during this period in Azerbaijan. Particularly, oil roar fuelled banking sector, existent estate and building. However, the growing rate of tradable sectors of Azerbaijan was small (Traveling Dutch) . Main non-oil exports of the state agribusiness and metals sector have non seen a important growing, intending state 's fight is non turning. In fact the state became dependent on oil sector, as it accounts for 90 % of exports and 60 % of GDP part (Chart 6. GDP composing by sector) . Current prognosiss predict that the oil roar of Azerbaijan will be comparatively ephemeral and oil production will get down to diminish in 2012, which will hold a prodigious negative impact on the economic system (Going Dutch) .

Dutch Disease effects have a important impact on the poorness rate of the state. Although life criterions have mostly improved, a high degree of poorness persists, particularly, in rural countries. About 42 % of the rural population live below the poorness line, and 13 % of hapless people live in utmost poorness (Rural poorness in Azerbaijan) . Despite the big GDP part of industry sector, chiefly oil and gas sector, laborforce represented by this sector is the least - by 12 % . However, agribusiness with the biggest laborforce business histories for 6 % in GDP part (Chart 7. Laborforce business by sector.) . This implies that chief laborforce of the state is located

in less competitory and less efficient sector, and the economic system must be diversified and fight of fabrication merchandises, owned by domestic houses, must be increased to minimise the high degree of poorness.

Decision

Although there are contradictory ideas about the impact of FDI on the economic growing, it is loosely believed that investings positively contribute to the economic development of host states. However, states do non profit from the investings at the same degree. Foreign investings are non advantageous or disadvantageous by themselves. Their part depends on the policy and behavior of host state authoritiess and MNEs.

The same foreign investing may convey tonss of benefits to one state, while it might be rather harmful for the other. Therefore, it does non intend that if you get more FDI, your economic system will hike. For illustration, Azerbaijan 's economic system grew significantly due to foreign investings, but if the authorities does non diversify the economic system and take steps against the negative effects of FDI, its economic system will be worsened in long term. The rising prices is increasing, non-oil sector is barely turning, and the economic system is going more and more dependent on the oil and gas sector, owned largely by foreign houses.

The survey implies that an appropriate policy and bit by bit improved `` absorbent capacity '' of authoritiess will minimise the negative effects of FDI and let these economic systems to harvest the benefits of investings at the upper limit.