Assess the arguments for and against foreign direct investment

Life

The topic of Foreign Direct Investment has both positive and negative debates in the increasingly globalised financialenvironment. The benefits of such movements include; increased employment levels, freer flow of capital, stimulating the local economy, and overcoming impediments to trade, whereas the negative implications are impeding upon national sovereignty, the 'race to the bottom', political instability, and the impact of Greenfield investment upon the environment.

The direction of this essay will be firstly defining the concept of foreign direct investment, analysing the benefits, then arguments against foreign direct investment, finally displaying the infinite benefits of foreign direct investment across the globe. Foreign direct investment became a prominent practice in the 1980's with the phenomenon of globalisation and the deregulation of many financial markets. " Foreign direct investment implies the acquisition and exertion of a significant control over a foreign firm" (Moosa, 2004, p. 02) and can be through either vertical or horizontal foreign direct investment (henceforth referred to as FDI); measurement of what is deemed significant control varying between nations.

The World Trade Organisation outlines FDI provisions, with the Uruguay round resulting in the outlining that restricts domestic content requirements. FDI is now the largest source of private capital reaching developing nations- the types, sector, source and duration of business (refer to appendix one) " all have a bearing on the successfulness of the endeavour for the country" (Gardiner, 2002, p.). Economic, political (government) and institutional factors are linked to FDI and allow for it to operate either successfully or unsuccessfully, including the area of income level (Wint and Williams, 2002,

p. 363); which can reducepovertylevels, according to Jenkins 2005; through the increase in growth and employment on the condition that this does not result in an increase in earnings being unevenly distributed. FDI is said to boost economic activity through total factor productivity growth (UNIDO, 2005, p. 2).

It may also assist a country's structural transformation such as financing modernisation and expansion of infrastructure and industries according to Pfeffermann 2002, which is of especial benefit to developing host nations. The openness of economies- freer flow of capital between nations expectedly influences positively the amount of FDI i. e. , absence of capital controls allows an organisation to fund unrestricted overseas ventures according to Kyrkilis and Pantelidis 2003, allowing firms to enter markets that they would otherwise be unable to.

The exchange rate can also be a favourable (or unfavourable) facilitator for firms from wealthier countries entering other nations, where the rate may mean that the entering nation has a larger(or smaller) amount of capital for their FDI - creating economies of scale. FDI requires significant amounts of capital and can also result in increased capital abundance through low interest rates in the host country.

Countries such as China and India are becoming an increasingly more attractive market due to their stable political environment, favourable macroeconomic polices and availability of labour which can increase employment in that particular region, according to McDonald, Tuselmann and Heise, 2003, as well as their close locations to large export markets

according to a study by AtKearney 2004; China leading America as the most attractive candidate for FDI in all sectors, showing the current trends in FDI.

There is an importance of host country institutions in equity ownership decisions (Asiedu and Esfahani, 2001, p. 648), that allow the movements of FDI to take place. It can often benefit the host country and their institutions, such as government, educational institutions and legal systems, through increasing funds. If the government has local content requirements in place, " may stimulate the local domestic economy by creating demand for local intermediate and primary products" (Lahiri and Ono, 1998, p. 45), hence proving to be more of an advantage to the development of the economy of FDI recipients.

One of the main advantages of FDI is that it is said to have decreased the severity of the 1990's Asian economic crisis according to Athukorala, 2003, through the diversification of investment within the region, allowing Asia to decrease the impact of the financial collapse on six of the major regions in Asia, and has allowed them to free up their economies and become more liberalised in attracting FDI (---, 1998, p. 1) into their boarders. FDI provides a way that the firm can overcome impediments to trade such as tariff barriers to overcome exporting blockages through setting up within a customs union and reaching their desired markets, as well as gaining technological knowledge transfer, location specific advantages, intangible resources according to Kyrkilis and Pantelidis 2003, and perhaps comparative advantages.

Gross domestic profit allows a country to measure the outputs, and hence the effects that FDI is having upon the nation - if the unit increases, this means that the country is reaping more financial benefit from the facilitation of investments into the country, according to Morgan and Katsikeas 1997, and the advantage of FDI is evident. The prominence of FDI clearly shows that it is successful, and that the capital flows between nations and willingness to locate subsidiaries overseas have amplified since the 1980's as a result of its achievements (refer to appendix two).

Disadvantages of lead to the debate that FDI may be viewed as a threat to the nationalcultureand impede upon national sovereignty, where the foreign firm views itself as more superior than the domestic firm and its interests. If the gains are not synergistic, then there may be a conflict of interest- further impacting upon national sovereignty, according to Wint and Williams 2005; and Hill 2005.

Wint and Williams, 2002 note that Singapore with the help of Richard Vernon endeavoured successfully in enticing FDI as per his theory of production factors, spurring a 'race to the bottom' (one of the most commented on disadvantages of FDI) as each competing country attempts to offer the most attractive incentives which essentially negatively impact upon the country's economic advancement. Host governments may offer substantial taxation incentives for FDI's within that nation; leading to " tax competition" (Lahiri and Ono, 1998, p. 44) where developing nations find themselves competing against each other to deliver the largest tax incentives.

According to Wint and Williams 2002, in 1998 of the145 regulatory alterations in 60 countries made, 94% of developing nations altered their polices to create a more favourable position for inward investing firms. In essence developed countries reap the benefits as they gain better tax breaks and other incentives to invest into the developing nations. This 'race to the bottom' leads to a decrease in potential profits for developing countries.

A lack of stability of constant FDI inflows can also harm developing nation's economies- with a large once off economic benefit from the initial establishment of the investment, for example the building of a Greenfield site -hence it may throw off the country's economic judgements. Political risk poses a threat in certain regions, where the company may be forced to close due to its link with particular home countries, for example, the recent conflict in Iraq has meant that many Western businesses in the area have been targeted with campaigns against them.

It may impact the stability of the fiscal framework and macroeconomic policies of the host country, as the governments may change often and policies along with them. According to the 2003 OECD Report, p. 168, countries with the largest amount of restrictions include Iceland, Canada, Turkey, Mexico, Australia, Austria, Korea and Japan (refer to appendix three), which are according to Hill 2005 consider wealthier nations.

The developing nations therefore are seen as more attractive candidates for FDI, according to Jenkins 2005, and hence compete with one another in their 'race to the bottom', as well as the act of regulatory arbitrage (Jenkins 2005) where a firm threatens to move its operations elsewhere so they may

manipulate more favourable regulatory regimes. , where authors criticise that FDI's success in developing nations is limited to the local ability to absorb FDI and the policy framework.

Distribution of FDI is a key reason why the World Bank criticises the phenomenon because it seemingly is concentrated in a few developing nations: The majority of countries according to Stiglitz as in Pfeffermann 2002, only benefit marginally from FDI, despite the sizeable increase in FDI since the 1980's. The environmental impact of FDI and in particular those from Greenfield investment where the site is cleared to make place for the new factory can have disastrous effects upon the natural ecological environment of the host nation, and cultural way of life.

Sourcing of raw materials cheaply from the host country may mean that the natural environment is compromised for profit and much needed economical growth within the developing regions. The Internationalisation Theory notes that cost reduction is a major cause for FDI (Jalilian, 1996), and based around " market imperfections" (Hill, 2005, p. 224) whereby new markets are sought to fill the lack of a factor of production within the home country; i. e. raw materials, human capital etc, where in essence a large proportion of developing nations are taken advantage of, for example, Nike and Disney in the 1990's.

The conclusion that can be brought forth from such evidence is that FDI has both negative and positive advantages in the form of increased employment levels, freer financial market flows, stimulation of local economies and overcoming impediments to trade, equalising a larger economical benefit

reaped from FDI, whereas the disadvantages include loss of national sovereignty, the 'race to the bottom, political instability and impacts of Greenfield investment upon the local environment.

It is evident, however, that the advantages of FDI far outweigh the limitations that are presented, through the increase in wealth, the spurring of economical development and increased activity in developing nations, essentially, benefiting the globalised financial and business environment.