

Foreign Direct Investment

- ? Have seen in previous lectures growing importance of international capital: though some debate how important. Clearly growing importance of MNCs and FDI
- ? When considering the option of moving abroad managers have a number of channels available:
 - o Exports of goods and services
 - o Direct investment in wholly owned subsidiaries
 - o Licensed production
 - o Joint ventures
 - o Strategic Alliances between number of firms
 - o Portfolio investment/cross equity holdings
- ? FDI is investment that directly leads to productive activity within the host country
- ? So while it is one useful indicator of the growth of international production, but is an underestimate Held et al
 - o Accounts for only 25% total invest in international production. MNCs raise money from a variety of sources
 - o Global production not just ownership and control but cross border production networks between firms –systematic data on this not available
- ? As we have seen Cantwell in Pitelis and Sugden groups theories of international production as:
 - o Market power theory of the firm
 - o Internalisation theory of the firm
 - o Eclectic theory of the firm
 - o Analysis of competitive international industries
 - o Macroeconomic developmental theories
- ? Have considered the firm and industry level so now look at more general issues. Though clearly they are linked.

Macroeconomic developmental theories

- ? Early theories Marxist and neoclassical did not deal well with growth of international production between international economies
 - o Marxist theories of imperialism: Marx – Lenin –Kautsky: search for raw materials, search for new markets with lower OCC, response to stagnation etc... Brewer (1990)
 - o Heckscher-Ohlin theory applied to FDI implied capital movements greater between countries whose proportional factor endowments are most dissimilar
 - o Theory that trade automatically balances based on comparative advantages

- ? New approach developed based on Product Cycle theory
 - o High incomes and demand in US foster innovation especially in consumer durables produced by labour saving techniques.
 - o Gives US firm competitive lead which export initially through exports then through import substit investment in the region catching up –Europe
 - o As product matures trade returns to cost det comparative advantage. MNCs lose cost advantage and have to use barriers to entry in marketing and distribution instead. See Cantwell
- ? Then technological leadership gave way to more balanced technol competition in 60s with Eur and Japan
- ? Rather than import substit invest, since 1970s have seen growing importance of global integration of affiliates within MNCs
- ? Another approach: Dunning's investment development cycle
 - o Level of inward and outward direct investment of countries and balance depends on their stage of development.
 - Poorest have very little –net invest close to zero
 - Higher level: mainly inward
 - Higher level development: increased outward but still negative net
 - Higher level increased outward zero then positive net
 - o Does seem countries embark on external much earlier in development process
- ? Dunning also adds character and composition of outward vary with level of development
 - o Early foreign ventures often resource based as firms mature move beyond single activity or product and adopt a more internat perspective .
 - o Characteristics of their activity and ownership advs become removed from conditions of home country
- ? Cantwell and Tolentino expand to argument about nature of countries themselves, Eur and US it has been going on for hundreds of years and resource related investment in LDCs overtaken by research related investment in industrialised economies
 - o Growth in developing country LDCs embarking on multinat expansion earlier than advanced economies did.
- ? Macro approaches to growth of internat production can be combined with competitive international industry:
 - o Types of inds involved in internat expansion vary with characts of country and the stage of devel it has reached and indust composition in turn influence macroeconomy

- ? Macro approach and market power: stagnationist tendency because of collusion
- ? Macro approach plus add in finance
 - o Growth leads to BoT surplus
 - o Strong domestic currency leads to internationalisation
 - o Can lead to conflict between domestic ind (want lower) and MNCs (want high)
- ? Dunning argues currency markets can effect timing of FDI but not long run trend. Probably better for portfolio invest flows rather than FDI.
- ? Case studies of industries show clear difference in the nature and extent of FDI. Held
- ? More recent developments:
 - o Improved transport and communications
 - o growth of networks of production
 - o internationalisation supply chains: outsourcing without ownership
 - o SME networks: Benneton: franchising ; co-op agreements
 - o Business services internationalisation: India
 - o Portfolio investment and cross ownership
 - o Joint ventures: share technology/specialise
 - o Strategic alliances
 - o Clusters
- ? Emerging global manufacturing sytem?

Economic Effects of FDI

- ? Considerable amounts of empirical work:
 - o Cross country
 - o Case study
 - o Empirical or qualitative
 - o Focusing on a range of factors
- ? Recently new growth theory has provided focus for empirical research and a powerful argument for benefits of FDI.
 - o emphasises role of human capitals R&D and externalities.
 - o Endogenous growth as although diminishing returns to factors are constant or increasing returns to scale.
 - o Social greater than private return as indiv invest adds to stock of knowledge and so productivity of the capital stock.
 - o There are also spillover and externality effects.
 - o Investment in knowledge subject to diminishing returns but use of such knowledge in productive activity leads to increasing returns
- ? Many of these growth promoting factors can be initiated and nurtured to promote growth through FDI

- FDI major source of technology and know how
 - FDI leads to transfer of management skills
 - FDI creates important externalities and spillovers
- ? FDI can help developing countries overcome constraints of low value of human capital and so low R&D
- Could spill over through training and managers moving
 - Could spill over via links between firms: subcontractors/suppliers
 - Local firms learn by watching
 - Local firm need to invest more to keep up with the competition from MNCs
- ? So new growth theory suggests FDI a potent force in promoting growth
- Exploiting it needs conducive economic and political environment: governance
 - Otherwise could be counterproductive
 - Many argue needs liberalisation to promote allocative and technological efficiency
 - Others less convinced
 - ✍ need to develop skills in developing countries
 - ✍ limited regional movements
- ? Balasubramanyam et al (1996): consider Bhagwati's hypothesis that the volume and efficiency of FDI will vary depending on whether the country follows export promotion or import substitution policies.
- They find evidence to support this.
 - Argue EP is neutral and supportive of MNCs
- ? Wider considerations include governance structure
- Globerman and Shapiro (2002) World Development
- ? Impact of FDI on host countries is an empirical question: –positive and negative effects possible
- Labour
 - Capital
 - Infrastructure
 - Spillovers: Harris and Robinson for UK, NIER, 2004
 - R&D/TP: Hubert and Pain for UK, SJPE 2001
 - Social relations
- Developed and developing differ
- ? Impact of FDI on provider countries is also an empirical question: –positive and negative effects possible. Internat can benefit the companies but not necessarily the country as a whole –impact of empires in past: Spain and Portugal.
- Labour
 - Capital
 - Infrastructure
 - Spillovers:

- R&D/TP:
- Social relations
- ? Tend to show positive effects, but are they asking the right question
 - Important distributional issues
 - Developing countries: Africa
 - Unpleasant activities
- ? Role of FDI only positive and important in countries that have achieved prior levels of development, infrastructure and skills to sustain growth
- ? Likely to continue to grow –but consider what happened pre war.
- ? Link to globalisation lectures at beginning of term
 - Trade reform/liberalisation agenda
 - Sceptical perspective has a point but globalisation still important
- ? Need to engage with globalisation to make increased international integration work in terms of desired development paths of countries.