Effects of Foreign Direct Investments on the Host Country

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Introduction

After decades of isolation, a developing country customarily unleashes a series of major political and economic reforms in hopes of transforming the country into a formidable player on the international stage. In the wake of such reforms, the country is enjoying tremendous supports from the international community keen on supporting the country in its process of change and opening. Moreover, investors are interested in this promising market prospect as the country is strategically located in the center of the world's fastest growing region in the digital era and is often deemed the last untapped economic frontier in the world.

In the years following the adoption of the Foreign Investment Laws, opening up the country to foreign direct investments (FDI), the host country can attracted investments in a variety of sectors such as real estate, manufacturing, logistics and tourism.

Effects of FDI on the Host Country

It has been recognized that the benefits of FDI for the host country can be significant and such benefits include technology spillovers, human capital formation support, enhancement of competitive business environment, contribution to international trade integration and improved enterprise development (Kastrati, 2013).

The effects of FDI on a host country can be both positive and negative. According to Hill (2003), FDI can affect host countries through resource-transfer effects, employment effect, effects on competition and production process innovation.

Resource-Transfer Effects

Resource-transfer effects can be categorized based on their effects on capital, technology and management resources. Such resource transfer can stimulate the economic growth of the host country (Hill, 2003).

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With regards to capital, MNCs invest in long-term projects, taking risks and reaping profits only when the projects yield returns. Many economists favor the free flow of capital and many MNCs, by virtue of their large size and financial strength, have access to financial resources not available to host country firms (Kastrati, 2013). Some researchers also emphasized a number of advantages that are related to unrestricted capital flow:

- International flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment;
- The global integration of capital markets can contribute to the spread of best practices of corporate governance, accounting rules and legal traditions.

Technology can stimulate economic development and industrialization. Technology can be incorporated in the production process (e.g., technology for discovering, extracting and refining oil) or it can be incorporated in a product (e.g., PC computers) (Hill, 2003). However, many countries lack the research and development resources and skills required to develop their own native product and processing technology, which is especially true in less developed nations. Thus, technology transfer via FDI has contributed largely to the productivity and economic growth in host countries. Technologies transferred also tend to be more modern and environmentally 'cleaner' than what is locally available (Kastrati, 2013).

By transferring knowledge, FDI will increase the existing stock of knowledge in the host country through training, transfer of skills and transfer of new managerial and organizational practice (Kastrati, 2013). Foreign management skills acquired through FDI may also produce important benefits for the host countries – beneficial spin-off effect arises when local personnel who are trained to occupy managerial, financial and technological posts in a subsidiary of a foreign MNC leave the firm and help to establish local companies, bringing their training with them. Similar benefits arise if the superior management skills of a foreign MNC stimulate local suppliers, distributors and competitors to improve their own management skills.

Workers also gain new skills through training. Training in foreign firms may often be of a higher quality. Workers take these skills with them when they re-enter the domestic labor market, helping the diffusion of such training into the labor market and helping improve the knowledge base in the domestic market.

Employment Effects

Employment effects associated with FDI are both direct and indirect. In countries where there are job shortages, the creation of employment, either directly or indirectly from FDI has been one of the most prominent impacts of FDI. The direct effect on employment arises when a foreign MNC employs a

number of host country citizens. Indirect effect arises when jobs are created in local suppliers as a result of the investment or when jobs are created because of increased local spending by employees of the MNC (Kastrati, 2013).

The domestic private sector can benefit by entering into business relationship with the new entrants, either through supplying inputs to these new companies (backward linkages) or processing a foreign investor's products (forward linkages) through subcontracting. Through either venue, extra jobs are created and further economic activity is encouraged. In addition, for every single direct job created by FDI, approximately 1.6 additional jobs were indirectly created through production linkages between FDI and local sectors (Kastrati, 2013).

Effects on Competition

The presence of foreign enterprises may greatly assist economic development by spurring domestic competition, eventually leading to higher productivity, lower prices and more efficient resource allocation. Increase competition also tends to stimulate capital investment in firms through investment in factories, equipment and R&D as these firms try to gain an edge over their rivals.

Costs of FDI to Host Country's Economy

In small economies, large foreign companies can and often end up abusing their dominant market position within the country hence FDI is not always in the interest of the host country. The adverse effects of unregulated FDI include reduced domestic research and development, diminished competition, crowding-out of domestic firms and lower employment. Moreover, sometimes the expected benefits of FDI may be elusive to the host economy if the economy in question is unable to take advantage of the technologies and knowledge transferred through FDI. In addition, certain factors in a developing country such as general education and health, technological level of host-country enterprises, insufficient openness to trade, weak competition and inadequate regulatory framework can hinder the full benefits of FDI.

With regards to the effects of FDI on employment, the new jobs created through foreign investment may not necessarily be new jobs created – jobs created by MNCs may be offset by the jobs lost in domestic companies.

The working conditions of workers in firms sponsored by FDI have also been a concern. The presence of sweatshops in some countries, coupled by child laborers, dangerous, sub-human working conditions with no minimal wage in place is a serious issue in some countries. Although multinationals pay their workers more than their competitions, many people have complained that multinationals abuse their workers in sweatshop conditions (Kastrati, 2013).

Subsidiaries of foreign MNCs may have greater economic power compared to local competitors. Moreover, often a part of large international organizations, foreign MNCs may be able to draw on funds generated elsewhere to subsidize its costs in the host market, which could drive local companies out of business. Such foreign companies may then begin to monopolize the market. This is a concern in countries that do not have large local firms of their own who will be able to withstand such threats foreign companies impose.

Another major concern regarding FDI is its environmental impacts. As some countries may have weak environmental protection legislations in place, foreign companies may take advantage of weakness and preform environmentally unfriendly practices which can have devastating results on the host country's environment.

Summary and Conclusion

Inflows of foreign investments can generate both favorable and harmful outcomes for the host economy, society and political system. FDI inflows through the entering of Multinational Corporations (MNC) into the country can bring benefits, such as job creation, introduction of new technology and financial capital to help developing the country and to improve its worldwide competitiveness. The downside effects of FDI inflow are on sustainability of the local companies whom may not have the necessary expertise, technology and capital to compete with foreign companies entering into the country.

The influx of FDI and MNCs entering the host country has naturally saturated local industries with competition both locally and internationally. It is become more important for native firms to reinvent themselves so that they remain their competitive advantage in the market.

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