Course: Foreign Direct Investment

Field of study: Economics

Form of classes: Regular/Online

Number of hours: 30 h

Number of ECTS credits: 5

Teaching methods: Lectures (including multi-modal presentations, individual projects)

Learning outcomes:

Students will get systematic knowledge about foreign capital and new policy mechanisms adopted by developed and emerging economies in order to attract foreign direct investment. It will help students to understand the importance of FDI (foreign direct investment) and identify strategically favourable destinations for its expansion. With the rise of globalisation, the opportunity of companies to become worldwide has become so great that the companies which are doing well within their countries, start the business in other countries to maximise the profit. Students will be also able to understand the new emerging trend of FDI, the flow of foreign capital between the emerging economies, it normally goes from developed to developing/emerging economies.

Evaluation methods of learning outcomes:
written test, activity during classes – solving tasks

The method of verification of the learning outcomes:
- Class attendance & active participation (10%),
- Essay/paper/portfolio (10%),
- Individual presentation (10%),
- Group presentation (10%),
- Individual project/group projects (20%),
- Written examination/Oral examination (40%).

Bibliography

Basic literature on the subject

Kumar P., *Foreign Capital Remains Buoyant for the Development of Indian Economy Beyond the Pandemic*. Scholar's Press, Mauritius/Germany 2020.

Kumar P., *The Determinants of Foreign Direct Investment in Emerging Economies: The Case of India and Poland*. LAP LAMBERT Academic Publishing, Mauritius/ Germany, 2020.

Barclay Lou Anne A., *Foreign Direct Investment in Emerging Economies: Corporate strategy and investment behaviour in the Caribbean*. Routledge, New York, 2000.

Aggarwal, Aradhna 2005. *The Influence of Labour Markets on FDI: Some Empirical Explorations in Export Oriented and Domestic Market Seeking FDI across Indian States*. Paper presented at the competitive section of the Global Conference on Business and Economics, held at the Oxford University, London, on 25th-27th June 2005.

Bengoa M., & Sanchez-Robles, B., *Foreign direct investment, economic freedom and growth: New evidence from Latin America*. European Journal of Political Economy, 19(3), 2003.

Kumar N., *Globalization, Foreign Direct Investment and Technology Transfers: Impacts on Prospects for Developing Countries*. Routledge, New York, 1998.

Kumar N., *Globalization and Quality of Foreign Direct Investment.* New Delhi, Oxford University Press, 2012.

Irving B. Kravis, *Availability and other influences on the commodity composition of Trade.* J.P.E., April 1956.

List of websites

https://www.ibef.org/economy/foreign-direct-investment.aspx

https://www.ustradenumbers.com/country/china/

https://www.ustradenumbers.com/country/india/

https://dipiufabc.files.wordpress.com/2015/06/dunning_multinational-enterprises-and-global-economy.pdf

https://www.mhrd.gov.in

http://www.oecd.org/investment/fdibenchmarkdefinition.htm

http://www.unctad.org

https://www.sciencedirect.com/science/article/pii/B9780444543141000021
https://www.nber.org/papers/w18775.pdf

https://webgate.ec.europa.eu/isdb_results/factsheets/country/details_india_en.pdf

Table of Contents

1. Introduction

This course is designed to enhance the knowledge about foreign capital through foreign direct investment. It is a method of direct investment into a business of a country by the company or individual of another country. This direct investment can be either in the shape of merger and acquisition of a company in a target country or by expanding business operations of a company in a target country. It is also differentiating between foreign direct investment and portfolio investment.
Foreign direct investment (FDI) means that any company or organisation can make direct investment in the production of another country. It can be made in various ways; by buying companies in another country or by expanding business into another country. Expanding business means opening a new business unit of existing business or opening a completely new business. There are a lot of reasons behind doing foreign investment; it may be because of taking advantage of low wages of a country, privileges like tax exemption which are given by some countries as an incentive to take advantage of tariff-free access to the region or of a specific market.
Here, we are also trying to understand the meaning of foreign capital, types of foreign capital, forms of foreign capital, its role, dangerous impact of foreign capital and private foreign investment.

2. Foreign Direct Investment (FDI)

Foreign direct investment and technology had been playing a very important role for the development of developed economies. They also had been playing a very crucial role for the development of developing economies. They are significantly contributing globally for the development of socio-economic exchanges. The classic examples include Poland, China and India.
Foreign investment plays an increasing role in economic development. Therefore, economic reforms and the far-reaching political changes have resulted in very substantial changes in the international capital flows. One of the ways by which foreign capital helps to stimulate the economic growth is facilitating essential imports required for carrying out development programmes, like capital goods, know-how, raw materials and other inputs and even consumer goods. The machinery, know-how and other inputs needed may not be indigenously available. Further, the increase in demand created by large investments may contribute to the necessity of consumer goods import. When the export earnings are insufficient to finance such vital imports, foreign capital could help reduce the foreign exchange gap. Moreover, foreign investment also helps increase a country's exports and reduce the import requirements if such investments take place in export-oriented and import-competing industries.

Foreign capital may be implemented through a lot of ways:

- Private foreign investment which is also known as portfolio or re-entering the investment. The new industrial enterprises may start thanks to foreigners. The capital for such concerns is allocated by foreigners in the form of shares;
- Foreign collaboration – which represents joint participation between domestic & foreign capital. There are three types of foreign collaborations:
    1. Joint participation between private parties,
    2. Between foreign companies and local government, and
    3. Between foreign government and local government;
- Inter-governmental loans – the developed countries provide grants and loans to governments of less developed countries;

- Loans from International Institutions – the International Bank of Reconstruction and Development (IBRD), International Monetary Fund (IMF), Asian Development Bank (ACB), etc., provide foreign capital;
- External Commercial Borrowings (ECB) – the export credit agencies like the US Exim Bank (Export-Import Bank of the United States), JEXIM (the Export-Import Bank of Japan), the Export Credit Guarantee Corporation of India (ECGC), United Kingdom, etc., supply major portion of the commercial borrowings from the capital market.

Foreign capital combined with skill and enterprise is essential for the development of underdeveloped countries in several ways:

- it is necessary to implement foreign capital when domestic capital is inadequate for the purpose of economic growth;
- foreign capital supplements domestic savings and it uses them to secure a rapid growth rate;
- it provides technological expertise and helps in building a modern industrial structure;
- it opens the way for the investment of domestic capital into new and desirable channels not used in the country before, due to lack of bold entrepreneurship;
- it provides valuable foreign exchange and it can facilitate pressures on the balance of payments;
- it can help developing countries in breaking the vicious circle of poverty;
- during the early stages of economic development of backward countries, the vast natural resources would be exploited quickly with foreign capital;
- foreign capital helping to import some of the essential goods of consumption can help contain inflationary pressures in the economy making the process of development relatively easy and smooth.

2.1. Difference between FDI and portfolio investment

Foreign direct investment is the opposite of portfolio investment. Within the portfolio investment a company buys stocks and bonds of different companies located in different countries. Foreign direct investment isa part of the national accounts of the country. Foreign direct investment does not include investments which are done by purchasing shares of another country.

Foreign direct investment is also called as the example of international factor movements. However, foreign direct investment does not involve investing in securities like bonds and stocks of another country. It is in contrast to portfolio investment. If a company buys 10% shares of any foreign company, then it will be categorised as portfolio investment. Foreign Direct Investment means:

- investment by branches of foreign companies,
- investment by subsidiaries of foreign companies, and
- investment by other foreign-controlled companies.

Portfolio investment means:

- equity holdings by non-residents in the recipient country’s joint-stock companies,
- credit capital from private sources abroad invested in the recipient country’s stock companies, and
- credit capital from official sources in the recipient country’s joint-stock companies.

2.2. Historical Development of FDI

Foreign trade or foreign capital is not a new term for the global economy. Nevertheless, the theory of foreign direct investment and literature about the activities of corporations spreading outside of their national boundaries have emerged in the last three decades. The concept includes the following phases:

I. *First Phase 1870-1914:* during this period, Multinational Enterprises (MNEs) were underestimated and not appreciated for their expansion to foreign countries. Foreign direct investment during this period was both the channel for the transfer of resources between different countries and the means of controlling the use of these resources for the complementary of local inputs. During this period, Europeans and the majority of the United Kingdom were the largest shareholders in the global stock of foreign investment.

II. *Second Phase 1918-1938:* due to the First World War, several European countries were in very bad shape and were not in the position to continue their investment projects as settled before the war, which affected the national as well as international production. At the same time, the consequences of war and changes in boundaries, European activities were eliminated from Russia. Only the USA remained fairly unscathed due to these events. During this time, foreign investments largely participated in some sectors, supplying products based on current demands.

III. *Third Phase 1939-1960:* after the Second World War, around the next thirty-five years international businesses have grown uninterruptedly. Unlike the First World War, the Second World War generated major technological advances, economic and political climate, which was helpful to improve foreign business activities. It was the time when the French and the Dutch capital involvement had more than its pre-war investment. In the years after the Second World War, worldwide FDI was commanded by the United States. The USA represented around 75% of new FDI (counting reinvested benefits) between 1945 and 1960. Since that time FDI has spread and turned into a legitimately worldwide sensation.

IV. *Fourth Phase 1960-1978:* between 1962 and 1977 the number of MNEs of USA origin declined. On the other hand, those of Japanese origin increased from 29 to 64 percent. And in the case of developing countries, it increased from 2 to 18 percent.

V. *Fifth Phase 1980-1991*: it was the period when FDI traditionally recorded an additional source of capital. It became more popular among the countries where domestic saving rates were low. A lot of developing and underdeveloped countries considered FDI as an important source of external finance. And countries started to bring reforms in their policies in order to attract MNEs. China is one of the best examples of such kinds of reforms. China's economic development has been remarkable since adopting the economic reform policy in the 1970s.

VI. Global FDI inflows and outflows 1990-2020.

3. New Trends in FDI since 1990

The 1990s brought considerable improvements in the investment climate, it partly influenced by the recognition of the benefits of FDI. The change in attitudes, in turn, led to a removal of direct obstacles to FDI and to an increase in the use of FDI incentives. Foreign Direct Investment is now considered as beneficial, and almost all the countries have tried to provide support for the investments from other countries. A lot of countries have started to recognise that they can bring foreign capital easily by being more liberal, and by opening markets. And it is only possible through bringing reforms in their economic policies and strengthening institutional mechanisms.

Technological advancements in communication and information industries have combined to create a new form of industrialisation, the form of industrialisation based increasingly upon the application of enhanced services for improvements in productivity. One consequence of this 'thought ware' economy is the increased interdependence and specialisation of production among trading nations. Increasingly, we witness the transnational sharing of production in which various segments of the production process are being parcelled out to countries with perceived competitive advantages. The growth of FDI depends in a great extent on the business cycle in both home and host countries.

3.1. Analysing BRICS

The emerging economies are considered as attractive destinations for foreign direct investment, globally. The BRICS countries that are Brazil, Russia, India, China and South Africa are the fastest growing economies in the world. The factor of economic growth is an attractive factor for foreign investors to invest in the growing economies to get an adequate return on investments.

Analysing BRICS by inflows and outflows of their FDIs measures in $ at current prices per capita.

A. Brazil

Brazil is one of the most attractive destinations for FDI. As shown in Figure 1, the trend for Brazil inflow has always been higher. Year 2011 recorded the highest inflows and it slowed down in 2012 and 2013. Again, with some up and down similar trends were followed until 2019.

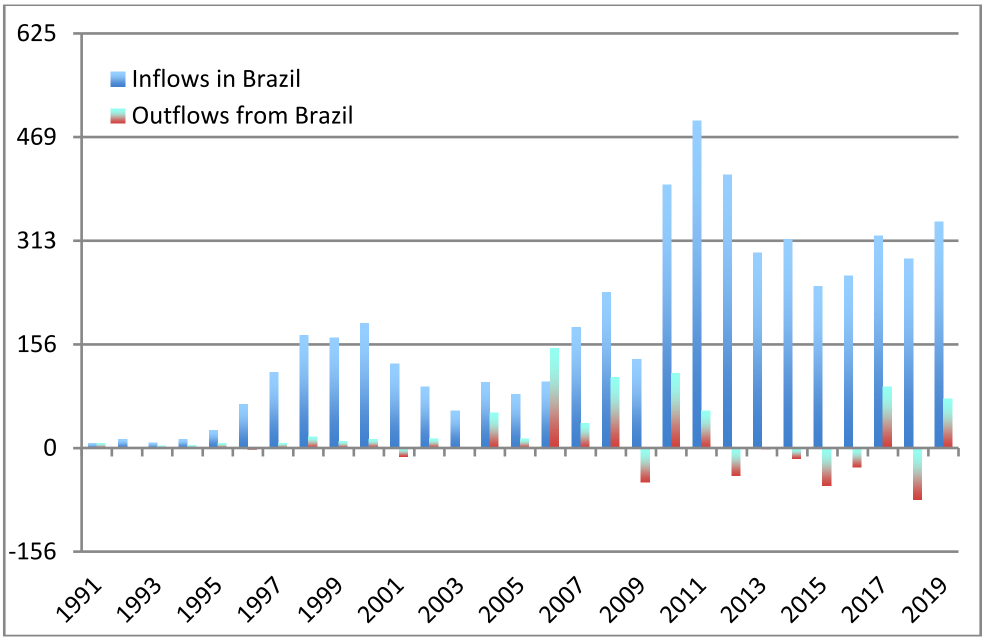

Figure 1. FDI Inflows & Outflows (Brazil)
Source: UNCTAD 2020[1]

The trend to receive inflows in Brazil is predicted to be increased post pandemic, and it will continue till 2030.

[1] UNCTAD Stat. https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.

B. Russia

Russia is quite a unique country in the BRICS group which is balanced with inflows as well as out-flows.

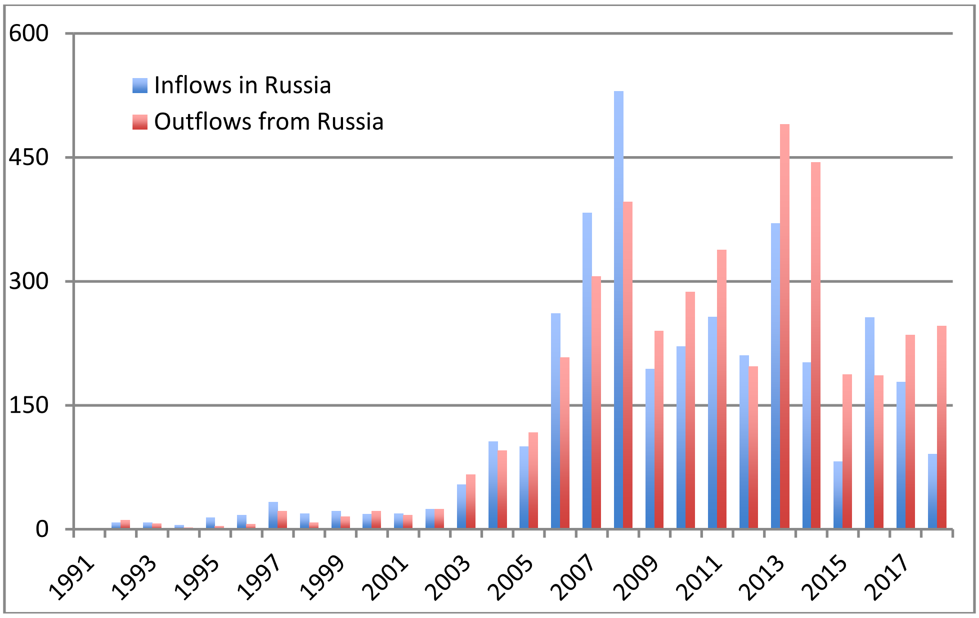

Figure 2. FDI Inflows & Outflows (Russia)
Source: UNCTAD 2020[2]

According to Figure 2, Russian investment going out of Russia is much higher than foreign capital coming inside the country in consecutive years 2013, 2014 and 2015. Outflow from Russia is higher than inflows in 2017 and 2018. In 2019, it has changed and higher inflows than outflows investments.

The trend of outflow in the year 2017 and 2018 can be also seen as a result of economic sanctions imposed by the European Union which affect the inflows of capital into Russia. Similar trends are expected in the post COVID-19 times, and it will continue at least for next 5 to 10 years.

[2] UNCTAD Stat. https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.

C. India

India is an important country under this group due to its continuous increase in inflows of FDI since 1999. Analysing data shows that India remains one of the favourite destinations for FDI in 2019, but Indian investment going abroad is also on the track to recover themselves and take more interest in the global market.

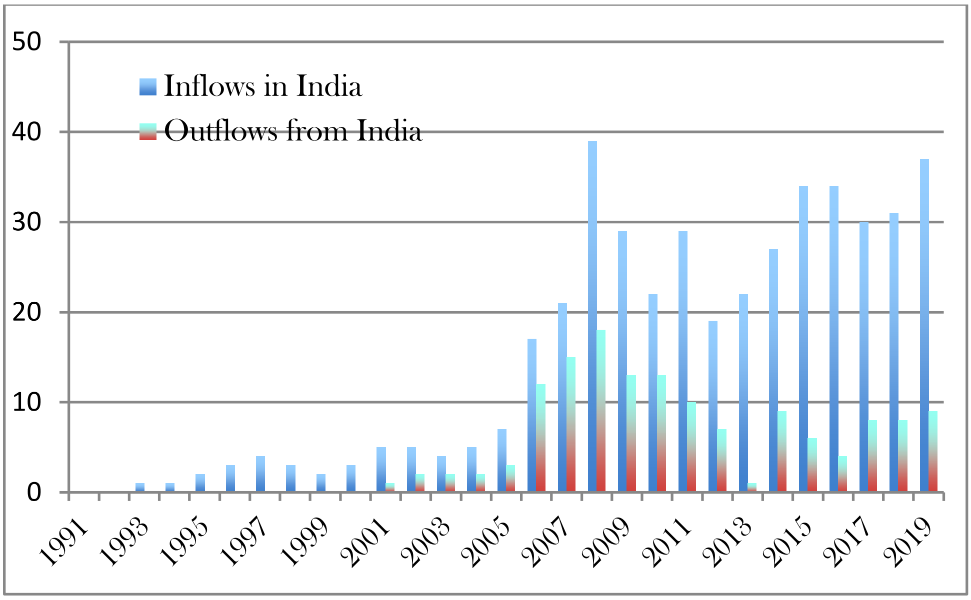

Figure 3. FDI Inflows & Outflows (India)
Source: UNCTAD[3]

India, being one of the fastest growing emerging markets received highest FDI inflows in 2008. According to Figure 3, after 2008, inflows to India slightly fell down due to the financial crisis, but they again recovered in a better way; at the same time outflows from India were still very slow. In 2001, Indian companies started to go abroad after the adoption of liberal policies by Indian government in 1999, which started to decline after 2008. Year 2013, was the lowest when it comes to the last ten years for outflows of FDI. Since 2017, and then, in 2018 and 2019 India received foreign investment with satisfactory growth rate and similarly outflows have been also growing.

The analysed data shows that India remains one of the favourite destinations for FDI in 2019, but Indian investment going abroad is also on the track to recover themselves and take more interest in the global market.

[3] UNCTAD Stat. https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.

D. China

China's position in the BRICS group is very crucial and important as being one of the highest recipients of Inflows of FDI in the member countries. Since 1991, inflows of FDI to China could be noticed, and its increase went higher, with some small fluctuations and continued until 2019 with a high record.

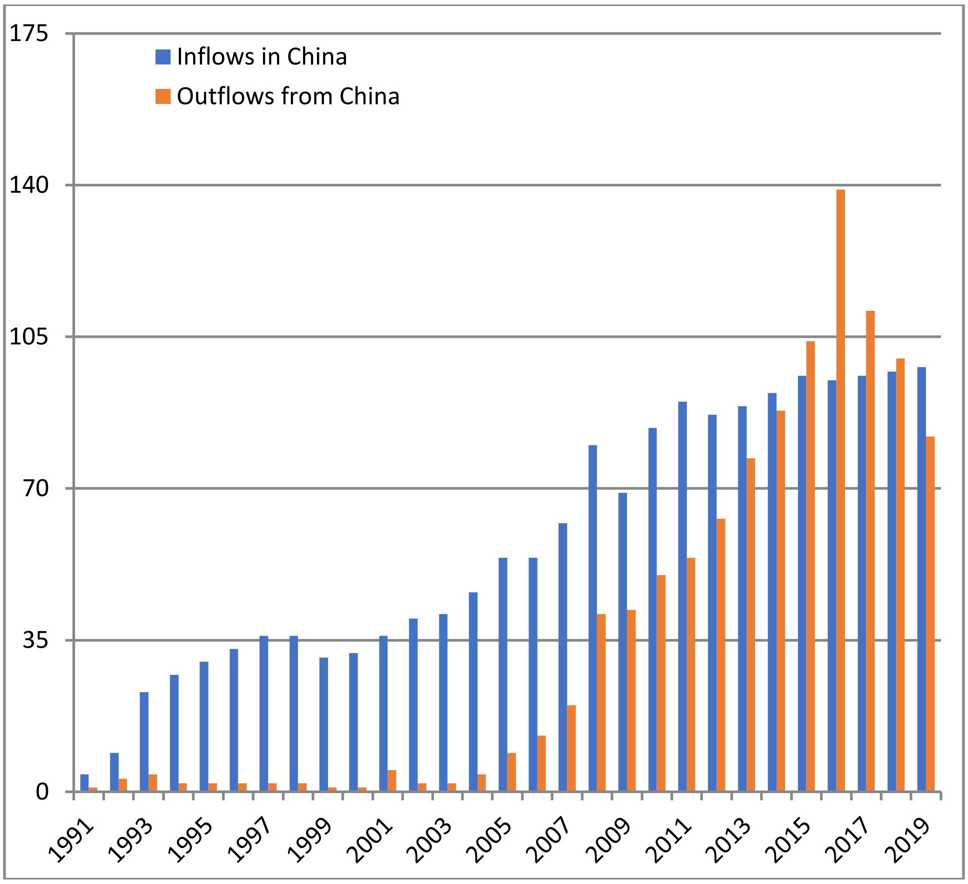

Figure 4. FDI Inflows & Outflows (China)
Source: UNCTAD[4]

[4] UNCTAD Stat. https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.

E. South Africa

South Africa as a country from African continent is of huge importance in this association of BRICS, due to its policies and geopolitical status. FDI inflows and outflows for South Africa have been fluctuating from 1993 to 2019. Evidently, it was important to notice that when inflows to South Africa had grown high, outflows from South Africa were the lowest or even in minus (-ve). Such trends were especially noticed in 2001, 2008, 2010, and 2011.

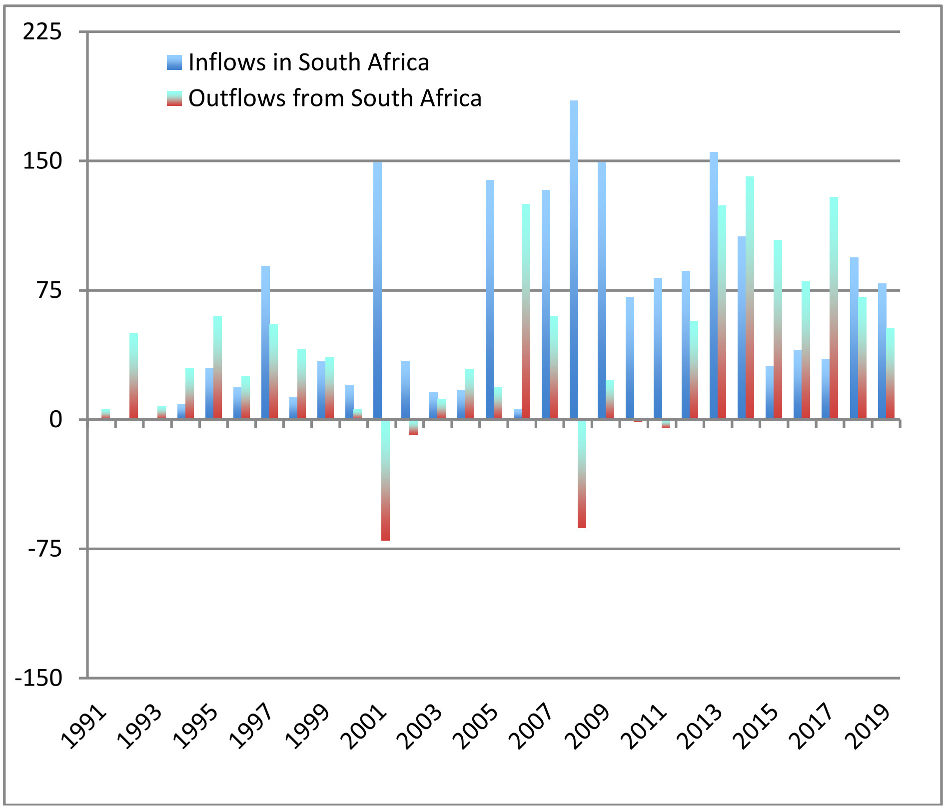

Figure 5. FDI Inflows & Outflows (South Africa)
Source: UNCTAD[5]

4. Applicable Theories of International Trade

4.1. Inter-regional and International Trade

A controversy has been going on among economists whether there is any difference between inter-regional or domestic trade and international trade. The classical economists held that there were fundamental differences between inter-regional trade and international trade. Accordingly, they propounded a separate theory of international trade which is known as the Theory of Comparative Costs.

There are several reasons to believe the classical views that international trade is fundamentally different from inter-regional trade which is fully applicable in Indian context.

[5] UNCTAD Stat. https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.

1. *Factor Immobility,*
2. *Differences in Natural Resources,*
3. *Geographical and Climate Differences,*
4. *Different Market,*
5. *Mobility of Goods,*
6. *Different Currencies,*
7. *Balance of Payments Problems,*
8. *Different Transport Costs,*
9. *Different Economic Environment,*
10. *Different Political Groups,*
11. *Different National Policies.*

4.2. Kenen's Theory of Human Capital

P. B. Kenen in the article in 1965 examined the role of human capital in international trade. He considered human capital, instead of physical capital as the main theme of his theory. Human capital is created by investing in the education and training of the labour force. Education, like investment in physical capital, requires time and it uses resources. The skills which education and training create, last a long time and tend to increase the productivity of the labour force. The wage differentials among types of labour rate are due to differences in education. But they cannot be improved upon without the application of capital. Education and training imparted to the labour force is the application of capital to labour.

4.3. The Kravis Theory of Availability

In 1956, I. B. Kravis, an American economist, propounded the theory that the commodity composition trade is determined primarily by 'availability'. Availability means an elastic supply. Trade relates only to those goods which are not available at home. By this phrase Kravis means-

A country will import those goods which are not available in the absolute sense, for example, a diamond;

Export those goods which are available in quantities greater than domestic demands.

Kravis has explained four factors which influence the availability:

a) *Natural Resources:* it is the availability of scarce natural resources that determines the trade pattern of a country.
b) *Technical changes:* technical knowledge that the given country has for producing particular goods which are then exported.
c) *Product differentiations:* it confers temporary monopoly of production on the innovating country so that it is able to export its commodity until the importing country imitates.
d) *Government policy:* government policy influences trade in a negative or positive way.

4.4. Liberalism Theory

Vernon's theory of liberalism is the most important theory related to the direct foreign investment developed by Raymond Vernon. This theory relates to the product-cycle model and explains the expansion of FDI to retain the competitive advantages in the foreign markets. According to the theory, the main motivation that is the basis for the FDI aroused from the desire to maintain market share and exploit technological comparative advantage.

John Dunning developed the OLI – ownership, location, internalisation model. This model is focused on the decisions to go global, with emphasis on characteristics of ownership and foreign location desirability. Dunning mentioned four groups of motivation for foreign investment. These are: resource seeking investment, market seeking, efficiency seeking and strategic assets seeking investments. Resource seeking investments focuses on the market where the firms can get raw material for production in an easy way. Market seeking investments is made where the trading limitations are not so strict and markets are comparatively large. Efficiency seeking investments are those investments that are made where the cost of production could be reported at lowest by availability of cheap labour and technology. Strategic assets seeking investments focus on the mergers and acquisitions or other strategic linkages.

4.5. Neo-liberalism Theory

Neo-liberalism is a trend of economic liberalism that supports free trade, economic liberalisation, open markets, deregulations, privatisation and increasing the private sector role in the economy and decreasing the influence of the public sector on the economy. Neo-liberalism theory suggests that the investors are attracted to the markets that are economically liberalised and have low barriers. This theory is mainly used by economists to make the legislative reforms of the markets.

5. Case Study:
Global and regional investment trends for India and Poland

In Poland, India is perceived as the most important non-European economic partner. Now, for the people from Poland, India is not only considered as the supplier of clothes, it is regarded as a powerful economy with strong and vast IT sector, financial and industrial sectors, business process outsourcing (BPO) which can play a significant role in the development of the Polish economy. Among the businessmen of Poland, the awareness of Indian power and abilities has grown in the recent times. Bilateral trade between Poland and India already increased and crossed 3.1 billion euros.

6. Determinants of Foreign Direct Investment

Explanatory variables	Indicators
Policy variables	• Motivation factors • Government incentives • Entry Strategies • Macroeconomic stability • Inflation rate • GDP per capita Income • Currency Exchange • FDI policy • Trade openness
Geopolitical location	• India’s location in South Asia • Availability of resources

Institutional variables	• Rule of Law • Democratic Values • Corruption • Bureaucratic complex • Specific Agencies for FDIs • Cultural differences • Language preferences • Union and local government
Political risk variables	• Political stability • Government effectiveness • Regulatory quality • Different policies at Union and local Government policies
Local Market characteristics	Market size • Availability of entrepreneurial, and management skills • Second largest consumer market in the world Growth • Ratio of Net FDI inflow to GDP Infrastructure

7. The impact of FDI on emerging economies

Foreign Direct Investment was considered as negative, unhelpful, and it was thought of as it brings technology that is inappropriate for the country. For almost 40 years, a different view regarding the Foreign Direct Investment has been emerging. Foreign Direct Investment is now considered as beneficial and almost all the countries have tried to provide welcome investments from other countries. The countries have started to recognise that they can attract FDI by using both the economic and FDI policies. Technological advancements in communication and information industries have combined to create a new form of industrialisation, the form of industrialisation based increasingly upon the application of enhanced services for improvements in productivity. One consequence of this 'thought ware' economy is the increased interdependence and specialisation of production among trading nations. Increasingly, we witness the transnational sharing of production in which various segments of the production process are being parcelled out to countries with perceived competitive advantages.

8. Project as case study: Poland as an investment destination in Central Eastern Europe

Students are supposed to complete the project by making a research outcome based on Polish investment policies and progress in order to present Poland as an investment destination in Central Eastern Europe.

9. Completion of the course

9.1. Evaluation of all results including projects and case study

- *Class attendance & active participation:* Active participation in class discussions presupposes that a student has presented the knowledge and notions from the lectures, the correct use of terminology and the understanding of basic ideas expressed in papers offered for home reading.

- Projects*/Case study/portfolio:* The element is given in the form of a written task.
- *Presentation:* Students are supposed to create presentations on the basis of the course material.
- *Individual/Group Projects:* a group project aimed at researching the given topic.

9.2. Final examination

The main goal of exam assessment is to assess the skills of critical thinking, abilities to take a new look at well-known facts and interpret them, intellectualise and speculate about main problems covered by the course, and to assess the use of English.

9.3. Sample Audit Questions:

A. Objective Question

Choose one correct answer from the multiple choice questions.

1. The less important company loses its identity and becomes part of the more important corporation, which retains its identity called:
a) Merger b) Acquisitions c) Merger & Acquisition d) None of the above

B. Short Questions

Write your own answers, minimum 7 sentences.

Choose five (5) points to answer them.

1. Define FDI, and explain why FDI is important.
2. What is portfolio investment?
3. How do you understand the meaning of Merger and Acquisitions?
4. Companies considering foreign investment. What do they analyse before the investment?
5. What are the determinants that influence FDI*?*
6. How market size effects-geographic proximity and labor coast?
7. Explain how Greenfield investment impacts the local system.

C. Long Questions

Write an essay, minimum 50 sentences. Choose one of the following topics.

1. FDI is good for some host countries. In what way and why? Explain in brief.
2. Explain advantages and disadvantages of FDI in home country as well as in host country.

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