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Potential Impact of Foreign Direct Investment on Emerging Economies

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Abstract: **FDI (Foreign Direct Investments) presents one of the leading components of globalization that has expanded since the 1990s and its influences on the emerging economies are beyond measure. The paper examines the various impacts associated with FDI on the economic growth of EMEs (emerging market economies), including the spurring of trade and competitiveness. Additionally, the methodology used is discussed detailing the choice of the correlational approach as the means of connecting the exponential economic growth in EMEs to FDI. Consequently, the paper addresses the benefits and application of FDI as a tool for realizing social development and the adoption of international practices among the EMEs. Additionally, some of the harmful practices, such as corruption, that reduce and minimize the potential benefits of FDI have been discussed. The research identifies the possible areas of improvement, including the need for empirical studies outlining the tangible benefits of FDI.**

Keywords: **emerging economies, foreign direct investment (FDI), international trade, globalization, risk, export, growth, economy, emerging market economies (EMEs))**

1. INTRODUCTION

Emerging markets, including India, Brazil, and China among others continue to prosper based on their economic policies that have attracted investors since the 1990s. Notably, the nations have benefited primarily from the FDI (foreign direct investment) channeled to various sectors of the economy. FDI inflows continue to increase as countries shift their policies from other financing options, including bank lending and issuance of bonds. EMEs (emerging market economies) have similar characteristics that include significant transformations to the political, social, and economic atmosphere. For example, China and India have undertaken rigorous liberalization policies shifting the economic outlook from government control to market-oriented environments. Privatization and deregulation of the state corporations and rules used in restricting business practices have contributed to the attraction of foreign investors (Figini and Gorg, 2011).

Emerging markets have other attractive features that increase FDI inflows, including the sizes of the population as exemplified by China, Brazil, and India. The three nations among others offer immense potential for multinationals and other foreign investors seeking to expand their customer base and tap the various resources of the EMEs. EMEs' liberalization of their economies attracts foreign investors because of the relative ease of doing business in such locations, as processes like licensing favor FDI (Chong and Lim, 2009). FDI offers the host countries tremendous opportunities for prosperity that include the development and advancement of the human capital skills, technology spillovers, increased competitiveness, economic growth and participation in international trade. Additionally, the conditions and entry of foreign investors enhance the integrity of the economy via the introduction of standards, such as the financial reporting avenues. Benefits accruing to the host country extend beyond the economic aspect and include other factors like environmental protection and the improvement of corporate policies that reduce retrogressive practices like corruption and the streamlining of wages.

The lives and standards of citizens in the host countries witness transformations because of the increase in employment opportunities linked directly to the foreign investments and the stimulation of an economy (Abor and Harvey, 2008). However, the benefits associated with FDI are not automatic and vary from one emerging economy to the next, but the effects of the economy are tangible over time. FDI can be linked with positive economic outcomes, including the injection of capital, managerial resources, and technology that differ from the dependency on debt financing. MNEs (multinational enterprises) offer the leading avenue through which foreign investments are channeled to the economies of the EMEs. The institutions take the risks associated with investment while providing employment and injecting finances to the local economy (Abor and Harvey, 2008). Therefore, the capital expenditures linked with FDI cannot be compared to other forms of financing, such as loans and issuance of securities.

The benefits related to FDI have been acknowledged, but it is hard to quantify them and assess the profits derived from external activities. Direct investments channeled to the emerging economies have increased from one hundred and four billion dollars in1980 to about a trillion dollars. The capital base created via the investments indicate the potential of spurring growth in the emerging economies, including the possibility of bridging the gap that exists between investments and savings. Capital scarcity offers one of the chief challenges to emerging economies, and its availability through FDI enhances the economic outlook of particular nations. Additionally, FDI's are associated with stability compared to other debt and equity capital flows (Choong and Lim, 2009). International firms establish operations in the host country, an aspect that has long-term spiral effects of investment and the transfer of technology to the EMEs. The discourse analyzes the various impacts associated with FDIs in the EMEs that include the injection of capital, improvement of the conditions in the labor market, reduction of corruption and economic growth among other notable influences (Denolf, 2008).

Evidence available detailing the impacts of FDI indicates the transformative nature of the investments on the EMEs but highlights the need for considering a range of factors like government control and corruption while evaluating the sustainability of the tool. Potential volatilities exist while reviewing the longevity of FDI based on the prevailing sentiments in the host country that could advocate for protectionist policies (Figini and Gorg, 2011). Macroeconomic conditions pose further challenges while considering the attraction of FDIs to EMES.

Purpose and Need for the Study

FDI as a concept has attracted concerns and changes, especially with the advancement of globalization. However, EMEs have opened up their economies to attract direct investments, as the channel for substituting some of the capital sources, including loans and the use of securities. The paper targets the identification of some of the impacts associated with FDI's on the host economies. Additionally, it provides a glimpse of the suitable economic conditions that facilitate the attraction of foreign investors to the EMEs. Further, the discourse explores the possible impacts of increments or reductions of the FDI directed to the EMEs, considering the competition received from some of the developing nations that compete for the attention of investors. The positive outlook linked with the enhancement of FDI to the emerging markets faces additional challenges concerning the protection of local firms and the domestic market.

The paper underlines the need for balancing the policy measures directed towards the attraction of foreign capital and its local businesses. The study facilitates the organization of the tangible benefits linked to FDI channeled to the EMEs that bridge the existing gap between savings and investments. The study targets the deepening of the research on FDI and its efficacy in boosting the economic growth of EMEs. Additionally, the study emanates from the desire to understand the influence of the local business environment in attracting foreign investments. Ideally, the use of the tool in the development of EMEs should indicate a convergence of the domestic policies about the global scenario. Some of the benefits accruing to the emerging economies extend beyond the economic scope and cover improvements in the society and the concern for the environment.

Objectives of the Study

The overall aim linked with this research was the collection of reliable information concerning the impacts associated with FDI on host economies, especially among EMEs. However, as part of the leading theme, the research included several specific objectives:

- To understand the elements that contribute to an increase in the reliance on FDI as compared to other financing options, such as loans.
- To examine the indirect impacts of FDI, including environmental and social changes experienced in EMEs.
- To evaluate the opportunities for expanding and maximizing the effects associated with the level of FDI in EMEs.
- To assess the potential negative implications linked to FDI as an avenue for realizing economic growth among EMEs.
- To describe the competitive scenario associated with FDI that faces EMEs from other developing nations across the globe.

Scope of the Study

This research concentrates on the tangible and direct impacts associated with FDI in EMEs while indicating some of the challenges that multinationals and other investors face while selecting the location of choice. The study excludes information concerning the global penetration of FDI and concentrates on its application by the emerging economies. Aspects included in the research include the use of FDI for capital basis, revamping of the economy, development of labor, and technology spillovers that benefit EMEs. Ideally, the study considers the importance of FDI in the growth and stimulation of economic activities among the emerging economies since the early 1990s. EMEs have increased their potential and trade position on the global platform, and as such, their economic activities influence international business decisions. The study evaluates information relevant to the leading EMEs that include Russia, China, Brazil, and India among other nations.

2. METHODOLOGY

The research relied on the numerous publications, studies, and literature available concerning FDI and its impacts on the economic growth of EMEs. The synthesis of research yielded the required information to understand the various elements and influences of FDI. A correlational approach was pursued in establishing the connection between the use of FDI and the sporadic growth of the emerging economies as exemplified by the cases of China and India. Data collection was based on the information available through online platforms and other publications with details about the impacts of FDI on EMEs.

Literature Review

Foreign direct investments have increasingly become a significant source of financing for the emerging countries. However, despite the benefits of FDI, if fiscal incentives are not sufficiently substantiated, the essential properties remain

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unclear. Among the main challenges is profitability; that is, how the returns on direct investments differ across countries considering the macroeconomic and regulatory risks in the host country (Figini and Gorg, 2011). The process of allocating cash flows to meet competing claims possible for investment in the developing economies is also a challenge. The competing claims include the dividend payouts to the patent firm and reinvestments in the income-generating affiliate.

FDI is a long-term commitment, and its impact on growth should not be underestimated. It is assumed that it only provides the additional capital; hence, the picture is not clear, because the inflows boost other quality aspects concerning life in the host country (Groh and Wich, 2012). Notably, if a developed capital market is existent in the host country, then the foreign investor can comfortably borrow the needed funds from the local market. The scenario is a cynical challenge because local investors might be crowded out, particularly if the MNE has the market power to gain preferential access. Additionally, the economy loses the positive effect on capital supply when the preferential treatment that is extended to MNEs as incentives to invest is reduced.

Considering some subsidies, the contribution of FDI to the overall economic growth can be lost, which is disadvantageous to the beneficiary economy. Investments in the emerging countries are at risk of sizeable capital leakages back to lender countries as exemplified by the possibility of repatriation exercises. Additionally, the competitive structure of the local economy is worsened as the emerging economies often exert significant market power, which facilitates in the collection of oligopolistic or monopolistic rents. Products offered by the multinational corporations are sometimes more capital intensive for the requirements of the host country (Seyoum, 2009).

However, should the technological advancement of the MNE exceed the absorptive capability of the host, there are limited effects experienced. For the advanced technologies to be useful, a certain level of human capital must be attained. Equally, the disadvantage is that FDI products are capital intensive and the infrastructure of the host country cannot support such needs. Such foreign direct investment creates dual economies, one backward domestic sector with a limited overlap and a modern sector (Mansoor, 2016). Investment of this nature results in excessively capital-intensive processes of production that lead to relatively less favorable development in the employment levels.

Foreign direct investments affect the emerging economies regarding the balance of payment financing. Foreign investment by a multinational corporation affects the host country's balance of payments in several ways (Seyoum, 2009). Usually, the recipient country experiences a one-time capital inflow, and later depending on the profitability function, it experiences an outflow of funds following profit repatriations. Further impact on the balance of payments emerges from the operations of the investors over time (Mansoor, 2016). The outcome can be either direct or indirect. Direct effects comprise of export revenues, inflows of equity capital, loans from the home country, payments of license fees, imports of goods both the capital goods and raw materials and interest.

On the other hand, the indirect effects of FDI in the host economies include changes inflows resulting from the substitution of local resources for the previously imported services and goods. However, the overall effect of FDI on trade inflow and outflow depends on the investment's motive. The investment could either target world market including the home country or the host country's market. FDI can be either vertical or horizontal. Horizontal FDI references to investment in a corporation that typically produces similar goods (Groh and Wich, 2012). The aim of Horizontal investment is to cross the trade barriers through the reduction of transaction costs.

However, such a move negatively influences the emerging economy as it dampens the previous imports of the local country because the export base is shifted inside the targeted market. On the contrary, if the horizontal investment is motivated by advantages in the costs of production, then the host country benefits through increased exports. Vertical FDI implies a situation where different production stages occur in various locations with the focus on the world market (Groh and Wich, 2012). Hence, it is hard to predict the effects of on balance of payments as the value added cannot be placed in each production stage and the internal pricing policies. However, the import content of output in the emerging markets is greater in the industrialized economies. FDI in the emerging economies is less beneficial regarding BOP compared to the developed and industrialized economies that are more advantageous.

In cases where profit repatriations are anticipated, FDI does not enhance a country's export capacity nor reduce the country's dependency on imports. Another adverse impact of FDI inflows in financing the current protracted imbalances is the prolonged unsustainable policies. FDI is ranked less volatile and more stable in the capital inflows of the emerging economies compared to other capital flows, such as banks and portfolio investments (Wen, 2007). Other types of capital inflows have the power to generate BOP crisis in situations where the investors suddenly decide to pull their money out of a given economy. Worth noting is the stability attribute of FDI stocks, and they are mostly fixed investments that cannot be liquidated at any substantial cost or short notice because they are fundamentally long-term in nature. The large size of FDI investment limits the possibility of liquidity as the long run strategy involves higher search costs in finding a potential buyer and a complicated replication in the future.

FDI have a stability-enhancing aspect in the emerging economies considering most of the income generated successively reinvested in the host country. The positive impact is that the affiliates of the multinational

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corporation in the emerging market access the international financial markets with ease compared to the challenges faced by purely domestic firms (Seyoum, 2009). The host country stands a better chance of tapping into foreign affiliate markets should it experience an increasing economic turbulence. Tapping from the multinational members reduces the overall distress levels in an economy. Notably, several factors can damage the positive effects of FDI in financing the current account imbalances. For example, in transition countries, FDI funds are privatized, an aspect that increases the efficacy of such investments (Han Byoung Sop, 2015).

Corruption significantly impedes the development of emerging economies as it hinders the effective establishment of FDIs. For some international investors having to deal with official extortion and paying bribes is equivalent to paying extra taxes. Corruption in the host countries negatively influences the level of foreign direct investment. Corruption erodes the domestic tax base and generates no revenue for the government. The increased involvement of FDIs in EMEs has raised social concerns and controversy. Notably, the MNEs are accused of engaging in unfair competition by taking advantage of unstandardized labor laws and low wages. Other accusations include the violation of labor legislation and human rights in the developing economies where the governments fail in enforcing such rights efficiently. MNEs has several advantages over the domestic firms that enable them to compete globally successfully.

Regardless of the additional cost of coordinating activities in foreign countries, they have the advantage of their technological know-how and the easier access to modern capital management practices. Another crucial impact of FDI on EMEs is the economic cycles of recession and financial meltdowns. Economic factors are important determinants of FDI after the regulatory framework of investments. Both the availability and lack of economic growth influences the demand for goods and services, and investment by the foreign affiliates. Declining demand for investment discourages MNEs involvement in the emerging markets. The geographical composition of an economy or region is a driving force for FDI (Wen, 2007). Most of FDI is destined for considerably industrialized countries because they are fast growing in the service sectors. Industrialized economies have larger markets and more promising in profitability expectations. The role of MNEs in the developing and emerging economies has triggered contemporary disputes over globalization merits. MNEs are perceived as the culprits of many global failures in the market segment.

Global competitive pressures substantially induce MNEs to find new methods of reducing the costs of production. Such demands amount to low costs of investing and supplying to exploit specific assets in different geographical locations (Han Byoung Sop, 2015). MNEs on local and global stages diversify through mergers and acquisition that affects the emerging market operations. The world financial crisis affects the developed and emerging economies, with much impact being felt by the developing economies. FDI inflows are drastically changed by the recession and the development projects in the EMEs are affected. Hence, foreign direct investment has a role in establishing the order of new economic powers.

Share of FDI to India, Brazil, China and Russia (Percentage)

Year	Percentage
2005-2007	11
2008	16
2009	16
2010	17
2011	17
2012	20
2013	22

The information provided indicates the consistent growth of FDI channeled to the four leading emerging nations as the share of the available investments globally. The countries offer lucrative destinations for investors and the statistical evidence collaborates the narrative detailing the increased reliance on FDI as the source for spurring economic changes. FDI has offered the impetus required to enhance the dominance of EMEs on the global economic front from eleven percent between 2005 and 2007 to doubled investments in 2013 (BRICS International Forum, 2016).

Research Methodology

The subjects of this study were the emerging markets, including India, Brazil, Russia, and China that represent the four leading nations in the category. The relationship between foreign investments and the growth of the industries in the EMEs was examined. The report details information gathered from numerous sources that indicate the views of researchers concerning the input and impetus of FDI on the economies of emerging nations. The data obtained was collected from various online resources, including journals and other empirical studies that concentrated on the subject matter. The issue of validity was addressed using an inclusion and exclusion criteria that detailed the need for research to contain information concerning the impacts of FDI on EMEs.

Further, peer-reviewed articles were included as the guiding sources for the research and the reinforcement of the validity of the arguments presented. The search terminology included FDI and emerging market economies, as the guides to the establishment of the relevant document contributing to the study. The methodology was suited and fitted the desired purpose of the study that was to analyze the choice of EMEs as FDI destination and examining the impact of such investments over the last three decades. Correlations were established detailing the level of development achieved in EMES and the input of foreign investments. Notably, the exponential growth in India, Brazil, China, and Russia offered the necessary support for the impetus associated with FDI since the early 1990s.

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3. CONCLUSION

MNEs are continually leading as the key drivers of the global economy following their investments in both the developed and emerging economies. The increased role of FDI has significant benefits that include the creation of high-quality jobs, technology advancement, and the introduction of modern management practices and policies. The impacts of FDI on the host emerging economy benefit the local firms in numerous ways including the realization of improved supply bases, export market access and the direct relations with customers and suppliers. However, the effect of FDI depends on the local stakeholders' ability to maximize the potential opportunities of the capital inflow. Nonetheless, the local regulatory framework should offer competitive conditions that are conducive to local entrepreneurship while equally avoiding the excessive market powers of the multinational investor.

Domestic firms should have the ability to learn from the foreign investors through an absorptive capacity approach. Firms undertake the foreign direct investment route if it suits the company's global strategy. Hence, government policies should focus on attracting companies that intend to invest in attractive projects without necessary changing what they do. Therefore, government agencies of the emerging economy should design incentive schemes that attract FDI. Some of the lucrative incentives include subsidies and tax breaks, especially for the projects that do not require particular connections to the local economy. A conducive business climate is critical for both the multinationals looking for investment locations as well as for the local entrepreneurs and firms seeking to benefit from such investments.

MNEs have the responsibility of raising the corporate social responsibility standards of the host country that extend beyond maximizing the shareholder's value. FDI can be beneficial to the local and host economy through the creation of high-quality jobs that are linked to better working conditions and higher pay. MNEs can also positively influence the quality of jobs available locally by passing knowledge from the foreign to domestic companies. Knowledge transfer can occur from worker mobility that is when the local firms recruit experienced employees from foreign corporations.

Changes in approaching the international level of investment flows have led to the increase in foreign direct investment worldwide. The recent wave of foreign investment invasion into the developing economies has seen the shutdown of domestic companies. The majority of the locally owned businesses fear losing control over industries and markets to the expanding MNEs. For the national firms to survive and compete with the MNEs, the local governments should revisit their policies. However, the emerging economies should be open to FDI and MNEs in the end. The government should put in place possible measures to curb the adverse effect on domestic businesses. Corruption discourages foreign investors because of the high cost of doing things. Hence, the host country should promote a favorable environment for the FDI through transparent political institutions. An open public sector and business climate is an effective way to combat corruption.

The government should increase product-market competition to strengthen incentives among local firms and to improve their efficiency. However, the policymakers should ensure that the local companies are not crowded out through reducing their ability to operate at economically efficient scale. The MNEs should overcome the moral dilemmas surrounding their establishment in the emerging economies. For example, employing underage children should be abolished and ethical standards upheld. Higher standards increase the positive effects of multinational corporations on the local economies; however, monitoring and defining standards involve a rise in the managerial challenges. As a greater number of firms continue undertaking FDIs, the global economy becomes integrated and interconnected. Foreign direct investment is a powerful tool that helps emerging countries come out of poverty and go through economic development.

4. LIMITATIONS AND RECOMMENDATIONS FOR FUTURE RESEARCH

Research work detailing information concerning the impacts associated with FDI on EMEs has several failures, including the challenge of generalizability of the results to the various emerging markets. Ideally, the effects of FDI vary from one country to the next regardless of the common factors that tie the nations and their classification as EMEs. The limitation exposed the research to inconclusive propositions about the specific aspects of the impacts to individual states. The second limitation concerned its reliance on the correlational approach for determining and evaluating the effects of FDI. Stronger conclusions could be achieved via the consideration of particular elements of the economy and the influence of FDI. For example, future research could benefit from the concentration in a particular industry, such as the retail section, and quantify its growth based on the financial performance of MNEs relative to that of local businesses. The present study lacked the capacity of understanding the perceptions of citizens in the various EMEs concerning the qualitative impacts of FDI. As identified in the literature section, FDI contributes to changes in the social structure and other aspects of environmental conservation that cannot be quantified. Therefore, future research should measure the societal and environmental changes linked to foreign investments in the emerging economies.

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