

FOREIGN DIRECT INVESTMENT FLOWS AND THE GLOBAL ECONOMIC CRISIS

Talamo Giuseppina*

* Faculty of Economics and Law, Kore University of Enna, Italy

Abstract

In recent years, Foreign Direct Investment has become an increasingly important feature of the globalized economy. The importance of FDI flows raises several of important questions. First of all is the question of the impact of FDI on host and home countries. Second crucial question is about FDI flows during the recent financial crisis and the role of FDI flows in promoting growth in less developed countries. Then, what can host countries do to become more attractive to foreign investors, and benefit from their activities?

Keywords: Foreign Direct Investment, Global Economic Crisis, Foreign Investors

1. INTRODUCTION

In recent years, Foreign Direct Investment (FDI) has become an increasingly important feature of the globalized economy. The rapid growth of global FDI reflects major underlying policy changes toward FDI in host and home countries. Additionally, as a consequence of a widespread liberalization of national investment policies, especially in developing countries and former centrally planned economies, many countries have now also adopted active FDI attraction strategies and policies. The importance of FDI flows raises several of important questions. First of all is the question of the impact of FDI on host and home countries. Second crucial question is about FDI flows during the recent financial crisis: in late 2007, at the beginning of the financial markets crisis, also FDI flows have been affected by the global recession. Some authors (Krugman and Obstfeld, 1999) considers FDI inflow to a country as a positive sign, suggesting that this is a result of a correction of a domestic distortion (crony capitalism). In contrast, other authors (Hausman and Fernandez-Arias, 2000) consider high level of FDI inflow as a sign of a weakness of the host country (poor property rights, inefficient markets and weak legal and financial institutions), rather than its strength. Then, the share of FDI inflows in total capital flows is larger when the legal and economic risks of doing business in a particular country are higher.

Recent attitudes toward FDI have changed considerably, as most countries have liberalised their policies to attract investment from multinational enterprises. In particular, structural adjustment programmes such as privatisation, trade liberalisation, reduction in state ownership, more and better transparency in economic systems, internationalisation of capital markets and macroeconomic stabilisation policies have led to increasing market integration at a global level, making FDI more interesting for both advanced and less advanced industrial countries. In this context, the key issues for both less developed countries and emerging economies is how to attract and retain

foreign investments, how to maximise the benefits of the foreign presence within the domestic economy, and choosing which policy to pursue? There is a still open debate over the appropriate policies and the macroeconomic response to the above-mentioned questions. Consequently, the role and effect of multinational enterprises debated within international economics and multinational enterprises are characterised by the fact that their international operations can have significant effects on both source and host countries. The purpose of this research is to analyze some of the important issues and trends in the contemporary debate on FDI, and to promote a wide-ranging discussion about the policy implications of these trends and events. The description of this research is divided as follows: Section 1: definition of direct investment; Section 2: review of the main literature; Section 3: comparative analysis and presentation of some data; Section 4: some critical considerations of two alternative approaches: climb to the top and race to the bottom theories and major problems and hypotheses addressed in this research. Section 5, concludes.

2. DEFINITION OF FDI

Foreign Direct Investment (FDI) is an international direct investment characterised by a long-term relationship and a significant degree of influence on the management of the enterprise in the host country. At the heart of the definition of FDI is the concept of control and ownership of another firm. According to the fifth edition of the IMF Balance of Payments Manual (BPM5) and the OECD Benchmark Definition of Foreign Direct Investment (Benchmark):

"Foreign Direct Investment is an international investment which is made with the objective of obtaining a lasting interest, by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial

transaction that establishes the relationship between the two entities, and all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. A direct investment enterprise is an incorporated or unincorporated enterprise in which a direct investor that is a resident of another economy has 10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). The direct investor may be an individual, an incorporated or unincorporated private or public enterprise, a government, or associated groups of individuals or enterprises that have direct investment enterprises in economies other than those in which the direct investors reside”.

Then, “...Foreign Direct Investment (direct investment) takes place when an investor (direct investor) based in one country (the home, source or parent country) acquires an asset in another country (the host country) with the intent to manage that asset (direct or indirect ownership)”. Thus, it is an investment made by firms or individual entrepreneurs that own and control assets in another country. The definition of direct investment enterprise extends to the branches and subsidiaries of the direct investor which can be directly or indirectly owned . BMP5 and the OECD Benchmark consider that direct investment statistics should cover all directly and indirectly owned subsidiaries, branches and associates.

Usually the terms “foreign direct investment” and “multinational enterprises” are used interchangeably. In reality these are characterised by some differences. International economic literature claims that a firm becomes multinational when it engages in foreign direct investment acquiring a substantial controlling interest (ownership, control) of a foreign firm in two or more countries. For example, a multinational enterprises works in a oligopolistic market and, through horizontal and vertical investment diversifies or fragment the foreign production of goods and services. Additionally, multinational enterprises can undertake economic activities independently of foreign direct investment, including licensing activities. Then, in this research the terms “multinational enterprises” and “foreign direct investment” will be not use interchangeably. In the next paragraph, we will identify the major themes and models of the literature on FDI and multinational activities.

Statistics on foreign direct investment are considered an important means in analysing the phenomenon of economic globalisation activities. In fact, at the national and international levels, policy recommendations are established in order to assist both source and host countries in maximizing the potential benefits and minimizing the adverse impact of FDI for the domestic economy. Data on FDI are generally compiled by national authorities, such as national central banks, national statistical institutes or investment promotion authorities and are collected and disseminated by regional-international organizations, such as UNCTAD, OECD, IMF and some statistical agencies (i.e. Eurostat).

International institution have also elaborate some index as the new FDI Contribution Index. This index shows relatively higher contributions by

foreign affiliates to host economies in developing countries, especially Africa, in terms of value added, employment and wage generation, tax revenues, export generation and capital formation. The rankings also show countries with less than expected FDI contributions, confirming that policy matters for maximizing positive and minimizing negative effects of FDI.

3. REVIEW OF THE MAIN LITERATURE

In general, in deciding whether to invest abroad, a multinational must develop a competitive advantage (i.e. economies of scale and scope, superior technology, managerial expertise etc.) powerful enough to compensate the firm for the potential disadvantages of operating abroad (higher agency costs, political risks, cultural and linguistic differences, unknown market, foreign exchange risks, etc.). In addition, in order to successfully compete abroad, a multinational must possess also some ownership-location (O,L) and internalisation (I) advantages, and it must combine these advantages in ways that maximise its market shares and growth. Much of the New Classical and New Trade Theory (NTT) have expended efforts on providing support for the increased importance of trade between industrialised countries and the prevalence of intra-industry specialization (horizontal and vertical patterns) between them, rather than the growing importance of multinationals relative to trade (Markusen and Venables, 1998). The theoretical challenge in terms of the pattern of multinationals' activities, however, lies in attempting to explain the existence of MNEs within the general equilibrium theory of trade. This means that one needs models to explain why some firms choose to invest abroad rather than exporting. To achieve this, trade economists have mainly relied on Dunning's OLI paradigm (1998) as a starting point. In it, MNEs are seen as firms which internalise a specific ownership advantage that provides them with some market power. Firms are willing to exploit this through FDI instead of exports in order to benefit from some location advantage and to avoid the possible asset dissipation that may occur, for example, with licensing. In the pioneering analyses of Markusen (1984) and Helpman (1985), firms are seen as being willing to engage in direct investment instead of alternatives such as exporting or licensing, if firm-level economies of scale are important relative to plant level economies. This may be the case if, for example, R&D activity is important for the firm, as R&D has some of the characteristics of a public good. In particular, the output of R&D can be transferred between different plants within the firm at low or zero costs (Markusen, 1995). This conclusion may be linked to an alternative explanation for the reason of direct investment flow across countries, which considers FDI as the flow of technology, knowledge and ideas abroad to be controlled by multinationals, which in turn contribute to a country's growth prospects. Additionally, it is important to note that the distinguishing features of direct investment are both control and transfer of knowledge. Producing abroad can be accomplished through subsidiary production or licensing, franchising, or other mode of entry such as joint venture, greenfield, merger and

acquisition. Each different mode of entry in a foreign market may be more appropriate than the others under different circumstances and each is an important factor in the project's success. Considering FDI as a transfer of technology, knowledge and ideas, the theory argues that a firm in order to overcome the disadvantages of investing in foreign markets, must possess firm specific advantage over local firms. Typical example of firm specific advantage is superior technology. The reason why multinational enterprises might want to relocate production abroad rather than sell its technology to a local firm is that in the latter case it loses control over its knowledge of technology. In other words, multinational enterprises want to enter the country in order to secure for themselves the economic benefit of the knowledge they created. On the other hand, host countries have interests in receiving knowledge spillovers from multinationals, because the multinational which owns the assets in the host country has been given the incentives to take its knowledge to the country. Strictly related to transfer of knowledge is the concept of spillovers. Many authors include spillovers (the external effect of FDI) among the consequences of direct investment, concluding that a firm must possess some specific assets (management skills, technology) to be able to compete in foreign markets and to capture the positive effects of direct investment.

In recent years the view of FDI has been influenced by the effects of financial crises. Some authors (Krugman and Obstfeld, 1999) considers FDI inflow to a country as a positive sign, suggesting that this is a result of a correction of a domestic distortion (crony capitalism). In contrast, other authors (Hausman and Fernandez-Arias, 2000) consider high level of FDI inflow as a sign of a weakness of the host country (poor property rights, inefficient markets and weak legal and financial institutions), rather than its strength. Then, the share of FDI inflows in total capital flows is larger when the legal and economic risks of doing business in a particular country are higher.

Even though there is currently no exhaustive general theory explaining FDI flows, new researchers (Shatz, 2000; Talamo, 2008; Fazio, Talamo, 2008, Talamo 2013) have recognised the importance of country-specific differences in political and institutional factors as determinants of direct investment. As a consequence, empirical studies claim that cross-country differences in growth and productivity may be related to differences in institutions, political stability, level of education and legal environment. Most of these studies conclude that the firm must design a strategy that will attract international investors. This requires improving the quality and level of firm's transparency: disclosure, i.e., making its accounting and reporting standards more transparent to foreign potential investors.

Consequently, recent attitudes toward FDI have changed considerably, as most countries have liberalised their policies to attract investment from multinational enterprises. Indeed, FDI has actively been promoted by the Washington consensus as a panacea for economic development. In particular, structural adjustment programmes such as privatisation, trade liberalisation, reduction in state ownership, more and better transparency in economic systems, internationalisation of capital

markets and macroeconomic stabilisation policies have led to increasing market integration at a global level, making FDI more interesting for both advanced and less advanced industrial countries.

In this context, the key issues for both less developed countries and emerging economies is how to attract and retain foreign investments, how to maximise the benefits of the foreign presence within the domestic economy, and choosing which policy to pursue?

These questions assume a special importance in an era of increasing global economic liberalization in which it has been recognised that, in order to realize FDI's full benefits and to increase FDI inflow, it is necessary to pursue policies that allow host countries to open up the local market to foreign investors. As a result, an increasing number of host governments have provided different forms of measures and incentives to encourage foreign firms to invest in their countries: fiscal incentives, financial incentives, infrastructures and monopoly rights.

4. A COMPARATIVE ANALYSIS

Recently, empirical works have found that the composition of FDI activities across countries varies significantly when considering host countries' policies and characteristics. Econometric analysis reveals that firm characteristics are only one part of the explanation behind investing abroad. Among traditional factors, multinational enterprises are influenced also by host country size in terms of GDP (the size of the market accessible to foreign investor), per capita income and distance from major investors. Empirical analysis (Shatz 2000, 2001), for example, using data of US multinational affiliates, reveals that the GDP accounts for about two-thirds of the variation in the worldwide distribution of production by multinational. Considering distance, for example, studies conclude that it can encourage or discourage investment. If a firm wishes to sell in a distant market and exporting is expensive due to transportation costs, one solution could be the creation of a subsidiary in that market. Thus, distance is strongly linked to transportation and coordination costs and, at the same time, it serves only as a proxy, having little effect on its own. Recent literature has also demonstrated that the quality of the investment climate may play an important role in the multinational enterprise's decisions. There has been an increasing acceptance that administrative procedure, corruption, bribery, legal rules, enforcement system, investment openness and transparency can significantly influence the location of multinational firms and their productivity. There are also a number of other general determinants concerning, for example, the level of education (i.e. secondary and higher education), the hosts country's infrastructure, national policies, investment openness, etc. All of these determinants contribute to higher levels of multinational enterprises activities. Thus, many authors and, in particular, international organisations believe that all these factors influence direct investment and multinational enterprise activities and consequently influences the opportunities for future investments. Empirical studies analysing the relationship between

FDI flows and indicators of economic development (i.e. GDP, GDP per capita, Population) found that FDI flows have been positively and significantly related to investment growth. There are several mechanisms through which FDI could generate positive spillovers for the receiving countries. First, part of the theory support the view that the beneficial effects of FDI flows are more likely to be detected when the receiving country has a certain amount of absorptive capacity in term of human capital, quality of governance and macroeconomic policies. For example, Borensztein et al (1998), find that FDI has a positive effect on growth when the level of human capital in the host country is sufficiently high (threshold effects). Thus, in order to benefit from the advanced technology introduced by foreign firms, the host country need to build up a certain amount of absorptive capacity in orders to take advantage of financial globalization. However, FDI may also lead to negative spillovers, as domestic firms may be displaced by the foreign firms, or find that the cost of factors of production increases as a result of the foreign direct investment. Second, authors (Cheng, 1999; Stiglitz 1999) support the view that benefits of FDI for the host countries may depend on the manner in which FDIs are attracted to a country. For example, in a context in which countries compete aggressively by offering subsidies to potential investors, it is possible that any potential net benefits generated by FDIs will be competed away, and will accrue to the foreign investors. As alternative way to attract FDI, authors have considered other forms of competition. For example, countries could compete by improving their governance, the quality of their labour forces or the quality of their infrastructures. For example, efficient legal systems, low levels of corruption, high degree of transparency and good corporate governance may have a quantitatively important impact on a country's ability to attract foreign direct investment. Countries with high level of human capital and good governance attract more FDI flows. In addition, lack of transparency and corruption have a strongly negative effect on FDI inflows. In particular, high degree of corruption may affect the composition of a country's capital inflows in a manner that market is more vulnerable to the risks of speculative attacks and contagion effects. Wheeler and Mody (1992) have tried to determine the relative importance of market size (measured by the population size) and the development level (per capita GDP) of the host country to account for FDI flows. They found that market size is more important for developed countries, while per capita GDP for developing countries. Wei (1997, 2000) find that corruption, as well as uncertainty regarding corruption, has significant and negative effects on FDI location. Hausmann et al. (2000), study the effects of institutional variables compiled by Kaufmann et al. (1999), as well as indices of creditor and shareholder rights from La Porta et al. (1998). They find that better institutions lead to a reduction of share of FDI inflows. They conclude that, in comparison to FDI, other forms of capital flows are more sensitive to the quality of institutions. Alesina and Dollar (2000) consider the traditional explanatory variables (market size: GDP, Population) and in addition they test for the impact on FDI of trade openness, the level of democracy and a set of

dummy variables including common religion and political alliances with the source country, the rule of law and the number of years as a colony of the host country). They use a panel of countries (1970-1994) and found that FDI responds to economic incentives, such as the trade regime and the system of property rights in the host country, more than to political incentives (e.g. colonial past and political links).

Several empirical contributions in the literature have recently used gravity models to explain FDI flows. Such models incorporate both macroeconomic and geographical factors as explanatory variables in the econometric model. In particular, beyond the market size, the development level of the host country and other institutional variables, FDI flows are assumed to depend upon the geographical distance between the home and the host country.

Recent data show that in 2011 the increasing flow of direct investment has been concentrated almost entirely in developed countries. Flows to developed countries increased by 21 per cent, to \$748 billion. In developing countries FDI increased by 11 per cent, reaching a record \$684 billion. FDI in the transition economies increased by 25 per cent to \$92 billion. Developing and transition economies respectively accounted for 45 per cent and 6 per cent of global FDI. UNCTAD's projections show these countries maintaining their high levels of investment over the next three years (UNCTAD, 2011).

5. FDI: A "CLIMB TO THE TOP" OR A "RACE TO THE BOTTOM"? SOME EXAMPLES AND POLICY CONSIDERATIONS

Recent attitudes toward FDI have changed considerably, as most countries have liberalised their policies to attract investment from multinational enterprises. Indeed, FDI has actively been promoted by the Washington consensus as a panacea for economic development. In particular, structural adjustment programmes such as privatisation, trade liberalisation, reduction in state ownership, more and better transparency in economic systems, internationalisation of capital markets and macroeconomic stabilisation policies have led to increasing market integration at a global level¹⁵, making FDI more interesting for both advanced and less advanced industrial countries.

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These questions assume a special importance in an era of increasing global economic liberalization in which it has been recognised that, in order to realize FDI's full benefits and to increase FDI inflow, it is necessary to pursue policies that allow host countries to open up the local market to foreign investors. As a result, an increasing number of host governments have provided different forms of measures and incentives to encourage foreign firms to invest in their countries: fiscal incentives,

¹⁵ These policies are associated with the so-called New Economic Model (NEM).

financial incentives, infrastructures and monopoly rights.

There is a still open debate over the appropriate policies and the macroeconomic response to the above-mentioned questions. Consequently, the role and effect of multinational enterprises debated within international economics and multinational enterprises are characterised by the fact that their international operations can have significant effects on both source and host countries. Advocates of the "climb to the top" approach consider that MNEs provide the best option for achieving efficient international financial markets and allocation of international capital flows. The theory suggests that MNEs tend to invest in countries with a high absorption capacity, good infrastructure and an educated work force. On the other hand, the school of the "race to the bottom" theory asserts that MNEs induce countries to compete against each other (countries offer subsidies, tax reductions and remove restrictions on the activities of MNEs) to attract FDI, thereby worsening their living standards. Furthermore, the benefits of MNE activities in less developed and emerging economies are not always reflected in domestic firms' value added growth. When domestic firms lack the capacity to absorb and internalise spillovers, FDI is not the most effective tool to promote technological and industrial development. In such cases the advantages of FDI go solely to the multinationals who can pursue their interests: profit's maximization, protection of its patents, blueprints and technology. In other words, there is the possibility that the liberalisation of restrictions on FDI only results in "a race to the bottom". In particular, we should be concerned whether the basic philosophy of neo-liberal policies, i.e. the neo-classical school of economics, offers an appropriate analytical framework. This problem with the race to the bottom can be examined in three aspects. Firstly, FDI does not necessarily go to the countries that have implemented deregulation or have offered some schemes to attract them. Secondly, it has not been proved theoretically whether the liberalised regime for FDI contributes to economic growth. Thirdly, there are several countries which have successfully achieved better economic performance by adopting strategic approaches to FDI (i.e. China). The race to the bottom approach holds that potential host countries compete with each other to attract FDI by removing restrictions on the activities of multinational firms and offering benefits them. As previously mentioned, determinants of FDI are associated with characteristics of potential host countries, such as institutional features, market size, and growth prospects linked with firm-specific assets, factor endowment and factor intensity. A race to the bottom approach relates especially to the institutional aspects of potential host countries whose governments can be changed by their policies. Examples are fiscal incentives, such as exemptions, financial incentives like subsidised loans and grants and non-financial incentives, such as basic infrastructure provision. On a more general level, measures can be the removal of the upper limit of shares multinational firms can acquire or the removal of the rule prohibiting entry of foreign companies, simplifications of procedures to admit their entries and lower standards of environment or

labour to enable them to cut production costs. These policies themselves are not inherently a race to the bottom. However, the problem is that, in the current global economic environment, this competition may result in incentive inflation, which would damage economies of the host countries. As a result, this may culminate in a race to the bottom.¹⁶ This competition has been taking place based on certain pictures drawn by neo-liberal economists. As Chang (1999) points out, there are three points in their arguments. Firstly, FDI is the main engine for globalisation and economic growth. Secondly, multinational firms have come to the stage in which they move their core activities outside their home countries. Thirdly, the hypothesis that liberal policies toward FDI benefit host countries has been proved by the experience of developing countries such as East and Southeast Asian countries. These arguments have various problems. Firstly, it is quite doubtful whether each point is accurate. Secondly, it seems that these neo-liberal views tend to ignore specific features of each FDI and each developing country. FDI has been flowing mostly among developed countries and the flows to developing countries have been concentrated into a few countries, generally in Southeast Asia and Latin America.¹⁷ It is obvious that FDI is unevenly dispersed throughout the world. Secondly, the insisted causality that FDI has pushed economic growth is only an assumption. In reality, multinational firms are likely to invest in the developing countries that grow rapidly or have potential to grow fast¹⁸, meaning that causation runs from growth prospects to FDI, not vice versa. Multinational firms may even be happy with strict restrictions as long as they are stable and predictable (Chang 1999). It seems that this is especially the case for the local market-oriented FDI because what matters is the market size and potential demand rather than the incentives offered by host countries. Thirdly, it is misleading to state that multinational firms are increasingly becoming transnational and even shifting their core activities such as R&D outside their home countries. As Chang (1999) argues, most multinational firms remain strongly rooted in their home countries and when they shift their core activities, the destination is mainly other developed countries. In addition, as discussed in the first part of this study, there are various types of FDI, which significantly differ in character. Thus, it is too general to evaluate them without distinguishing certain categories. In conclusion, liberal policies toward FDI do not necessarily attract multinational firms. It now seems clear that the neo-liberal implications that FDI brings benefits to host countries have been based on the misunderstanding, or at least too simplistic comprehension, of basic phenomena.

In general, FDI itself is neither good nor bad, meaning it can bring both positive and/or negative spillovers. The effects depend on the conditions and context in which certain FDI takes place. Thus, it is important to analyse the current international environment for FDI as well as the features and conditions of host countries and FDI. Firstly, features of specific FDI should be taken into

¹⁶Kozul-Wright & Rowthorn, 1998.

¹⁷ Kozul-Wright & Rowthorn 1998, De Mello 1997.

¹⁸ Chang 1999, Kozul-Wright, 1998.

consideration. In the case of so-called footloose investments, for example garment and toys industries, there is a high danger that multinational firms withdraw from the country as soon as they exploit or take advantage of incentives offered by host countries without transferring any technologies. However, the other FDI such as chemicals, electronics and automobiles that involves higher sunk costs in establishing subsidiaries and/or that necessarily creates networks with continuous efforts, is not easily withdrawn once subsidiaries are established (Chang 1999). Secondly, differences in the characteristics of countries is important. There are some cases that host countries gain relatively strong bargaining power over multinational corporations (Chang 1999). For example, in the case of countries like China and India, which have large potential domestic markets, local-market oriented FDIs compete with each other for entry, putting the potential host country in a superior position over multinational corporations. In the case of resource-oriented FDI, there may be some cases that host countries, which are endowed with specific natural resources such as mining or with particular types of skilled labour, eventually gain bargaining strength over multinational firms. However, if countries have no such advantages, the bargaining power of national firms dominates. Thirdly, the current world environment for FDI should not be overlooked. Crotty, Epstein & Kelly (1998) point out that, in the current regime, the race to the bottom outcome is most likely. They argue that the threat of moving by multinational corporations has negative effects on wages, working conditions and tax rates by lowering bargaining power of host or potential host countries. This view seems persuasive, firstly because mainstream optimistic views are based on the insufficient understanding of the underlying situation as discussed above. Secondly, as Crotty, Epstein & Kelly (1998) stress, in the current neo-liberal regime, aggregate demand is insufficient to achieve full employment and effective rules controlling the activities of multinational firms are absent, and thus competition between countries to invite them is destructive. This is because the neo-classical school of economics, in the belief that the market is almighty, discourages state intervention for markets and recommends the removal of restrictions on FDI. The international institutions dominated by the neo-classical school of economists tend to advise that there is no alternative for developing countries to grow faster but to compete in the invitation of multinational firms.

It is clear from the above discussions that the implications of neo-liberal economists that multinational firms bring benefits to host countries have not been proved theoretically. Rather, the outcomes of FDI on host countries depend upon contexts and circumstances. Furthermore, under the current neo-liberal regime, there are high risks for the developing countries to engage in the race to the bottom, as they are losing their potential control even over the footloose or speculative activities of multinational corporations. As Kozul-Wright (1995) rightly points out, "measures to attract FDI will be of limited success unless selective-supply-side measure can be used to ensure that stronger links with international production are consistent with the

continuous upgrading of domestic economic activity"(p.167).

The other assertion of neo-liberal economists that some developing countries have achieved better economic performance through a liberal approach toward FDI is inaccurate, as well. The policies of developing countries toward FDI, which achieved rapid economic growth, were not always to liberalise the restrictions imposed on the activities of multinational corporations. Countries like Korea and Taiwan, for example, took a strategic approach to FDI. Although they were not hostile to multinational firms, they had kept strict regulations in regard to entry of and ownership by foreign firms during their heyday of economic development (Chang 1999). While domestic market oriented industries, such as durable consumer goods, were reserved for domestic companies, multinational firms were welcomed in industries involving high technology, such as petroleum refining, or labour intensive export industries, such as electronics assembly. Furthermore, the governments of those countries preferred and promoted the invitation of FDI in the form of joint ventures so that technologies and management skills were likely to be transferred. These experiences of Korea and Taiwan show that it was their strategic approach towards FDI that brought them fruitful results. As Chang (1999) stresses, the role of multinational firms "needs to be clearly defined in relation to the overall industrialization strategy and with reference to the specific needs of the particular industries concerned"(p.107). In that sense, the nation-states shall take strategic and selective approach to FDI to assure knowledge and technology transfers by inviting multinational firms, rather than engaging in the race to the bottom approach.¹⁹

The other cause of the race to the bottom is the absence of international institutions and international rules dealing with multinational firms and FDI. Tolentino (1999) argues the possibility of building international rules through WTO for the activities of multinational firms as well as for the activities of potential host countries to invite them. If these rules enable and promote potential host countries to take strategic approach toward FDI, it seems that realisation of such rules is important for developing countries. This is because, in the current neo-liberal regime, countries without any relative bargaining strength over multinational firms cannot but compete to the bottom to invite them at the cost of workers and communities of the country. In the light of this debate, several studies investigate whether multinationals can improve the growth prospects of countries by improving the quality of institutions. Economists and international organisations tend to view good governance (UNCTAD, Kaufmann) as one possible conduit for first attracting and then retaining FDI and therefore affecting countries' economic performance.

A particular case is China that have experienced the success of multinational investments in expanding exports and gaining new technologies. Chinese FDI flows are more focused on developing countries and, in particular, ASEAN countries and Africa have become the main goals of Chinese investments (UNCTAD, IMF). In particular,

¹⁹ Kozul-Wright 1995.

for several years, China has shifted its foreign investment on African continent, investing billions of dollars to ensure all natural resources essential to its economy and to affirm the political influence of Beijing on developing countries. Chinese FDIs are diversified in 48 countries of the African continent. Most of these (54.6% of the total) reaches States that are rich in natural resources. All relations between China and the Ssub- Saharan African countries have experienced a boom between 2000 and 2008 (the year in which they exceeded 100 billion U.S. dollars). This increase of FDI flows in Africa is a general result of a growing social cooperation, economic and political relations. Despite the global economic crisis, the value of Chinese investments it is always more stable compared to Western countries, who instead tend to fluctuate significantly. The greater stability of Chinese FDI may depend on the fact that the majority of firms investing in the Asian country is state-owned. The majority of Chinese FDI has been made in the natural resources sector , which absorbed about 75% of FDI . More than half of the investments in mergers & acquisitions are made for 90% of Chinese public companies and involved commodities sector. Chinese investment in Africa focus more on manufacturing, extraction of natural resources, in the construction of infrastructure, and to a lesser extent in agriculture, tourism and goods. Investment in textile and manufacturing are performed as China has a relatively advanced technology in the production of textiles and clothing. The extraction of natural resources is a very important sector as China, despite having a vast territory, has few natural resources . Natural resources are fundamental to the domestic industry in expansion and economic growth of the country. Investing abroad in these areas China meets its domestic needs. The Chinese government has also identified a number of areas and types of projects in Africa that encourages its businesses to invest. Chinese FDI flows to African countries have focused mainly in sub -Saharan Africa , as this is one of the world's richest areas of natural resources. However, Sub -Saharan Africa countries attract foreign investments for its natural resources , the low cost of labor and as consequences , the pattern of growth that occurs has different origins than those that have characterize the Chinese economic boom. Several are the motivations that drive Chinese enterprises to invest in African countries: · direct access to the market; increased market penetration; re-use of materials; to establish import quotas imposed on Chinese products important for the textile industry and for industrial products. Chinese FDI are diversified in 48 countries of the African continent, but most of these FDIs (54.6% of the total) reaches State that are rich in natural resources (Angola , Nigeria, South Africa, Congo, Gabon, Sudan and Zambia). For example, Nigerian oil sector represents the largest recipient of FDI flows, and also other countries such as Ghana and Liberia have had a growing number of investments in some crucial sector. For some African countries, FDI Chinese flows have become the only investor and the Chinese capital is considered as essential in promoting growth and investments. In the last years, and during the economic crisis, the number of Chinese FDI projects in Africa has grown and has attracted 82 billion FDI flows and IMF estimates

that it could reach \$ 150 billion by 2015. In particular, the number of FDI flows in Sub -Saharan Africa grew by 27% compared to 2010, in particular this growth occurred in metals, telecommunications and in food and tobacco. According to IMF, Sub-Saharan Africa countries is expected to grow by an annual average of 5.5%. Despite these good percentage, it is possible to present some doubts on the economic relations between China and Africa. This is because, for example, the 95% of agreements on investments between China and sub-Saharan countries present some clauses stipulating that, 70% of workers hired for the performance of the works have Chinese nationality and only 30 % of the shares is reserved to the local people. In addition, African workers are usually hired at low wage level and poor working assistance. Finally, it is also possible to see some dumping phenomena that have forced many small- medium African entrepreneurs out of the market, while large Chinese companies get benefits from the central government that allow to import products (oil, minerals) at lower prices than market value. Then the role of Chinese foreign investment in Sub -Saharan Africa countries is still ambiguous.

CONCLUSION

This study²⁰ aims to investigate the determinants FDI flows across countries before and during the recent financial crisis. In particular, it explores the role played by both institutional, geographic and other variables on FDI location and mode of entry into a foreign market. In this context, the key issues for both less developed countries and emerging economies is how to attract and retain foreign investments, how to maximise the benefits of the foreign presence within the domestic economy, and choosing which policy to pursue? These questions assume a special importance in an era of increasing global economic liberalization in which it has been recognised that, in order to realize FDI's full benefits and to increase FDI inflow, it is necessary to pursue policies that allow host countries to open up the local market to foreign investors. As a result, an increasing number of host governments have provided different forms of measures and incentives to encourage foreign firms to invest in their countries: fiscal incentives, financial incentives, infrastructures and monopoly rights.

There is a still open debate over the appropriate policies and the macroeconomic response to the above-mentioned questions. Consequently, the role and effect of multinational enterprises debated within international economics and multinational enterprises are characterised by the fact that their international operations can have significant effects on both source and host countries. Advocates of the "climb to the top" approach consider that MNEs provide the best option for achieving efficient international financial markets and allocation of international capital flows. The theory suggests that MNEs tend to invest in countries with a high absorption capacity, good infrastructure and an educated work force. On the other hand, the school of the "race to the bottom" theory asserts that MNEs induce countries to

²⁰ This article is a synthesis of a monograph " Foreign Direct Investment and the Global Economic Crisis", G. Talamo, 2013

compete against each other (countries offer subsidies, tax reductions and remove restrictions on the activities of MNEs) to attract FDI, thereby worsening their living standards. Furthermore, the benefits of MNE activities in less developed and emerging economies are not always reflected in domestic firms' value added growth. When domestic firms lack the capacity to absorb and internalise spillovers, FDI is not the most effective tool to promote technological and industrial development. In such cases the advantages of FDI go solely to the multinationals who can pursue their interests: profit's maximization, protection of its patents, blueprints and technology.

In conclusion, multinational activities have been and still are the focus of hopes and disappointment.

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