**4.5 The Role of foreign direct investment**

**- FDI and MNCs**

**Syllabus item: 174 Weight: 3**

**Main idea 1**

MNCs are attracted to developing countries for a number of reasons:

* The country may be rich in **natural resources**, such as oil and minerals

Ex) Angola, Equatorial Guinea, Nigeria and Sudan

* Some developing countries represent huge and growing markets. If MNCs are located directly in the markets then they have much better access to the large number of potential consumers ex) Brazil, China and India
* The **cost of labour are cheaper** then in more developed countries
* In many developing countries, **government regulations are much less severe** than those in developed countries

🡪 Making companies easier to set up and reduce costs of production

🡪 Offering of tax concessions by developing countries’ governments attract FDI

**Definition:**

• Foreign direct investment (FDI)

🡪 Long-term investment by multinational corporations (MNCs) in countries overseas.

FDI usually occurs in one of two ways:

1. Build new plants or expand their existing facilities in foreign countries (green field investment)
2. MNCs merge with or acquire (buy) existing firms in foreign countries

**IB Question**

• Describe the nature of foreign direct investment (FDI) and multinational corporations (MNCs).

• Explain the reasons why MNCs expand into economically less developed countries.

• Describe the characteristics of economically less developed countries that attract FDI, including low cost factor inputs, a regulatory framework that favours profit repatriation and favourable tax rules.

**Main idea 2**

Table: The world’s top 8 non-financial MNCs, ranked by foreign assets, 2007

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Corporation** | **Home economy** | **Industry** | **Foreign assets** | **Total assets** | **Foreign employment** | **Total employment** |
| General electric | US | Electrical & electronic equipment | 420300 | 795337 | 168112 | 327000 |
| Vodafone Group plc | UK | Telecommunications | 230600 | 254948 | 62008 | 72375 |
| Royal Dutch/Shell group | Netherlands/UK | Petroleum expl./ref./distr. | 196828 | 269470 | 86000 | 104000 |
| British Petroleum Co, plc | UK | Petroleum expl./ref./distr. | 185323 | 236076 | 80600 | 97600 |
| ExxonMobil Corp. | US | Petroleum expl./ref./distr. | 174726 | 242082 | 50904 | 80800 |
| Toyota Motor Corporation | Japan | Motor vehicles | 153406 | 284722 | 121775 | 316121 |
| Total | France | Petroleum expl./ref./distr. | 143814 | 167144 | 59146 | 96442 |
| Electricité De France | France | Electricity, gas, and water | 128971 | 274031 | 16971 | 154033 |

**IB Question**

• Evaluate the impact of foreign direct investment (FDI) for economically less developed countries.

**Main idea 1**

Advantages associated with FDI

* FDI **helps to fill the saving gaps** leading to economic growth (Increased savings are necessary for growth)
* MNCs will **provide employment** in the country and, in many cases may also provide education and training 🡪 Improve the skill levels of work force and also managerial capabilities
* MNCs allow developing countries **greater access to R&D, technology, and marketing expertise** 🡪 enhance the industrialization
* Increased employment and earnings may have a multiplier effect on the host economy, stimulating growth
* The host government **may gain tax revenue** from the profits of the MNC, which can then be used to gain more growth by investing in infrastructure, or to improve public services such as health and education to promote economic development
* If MNCs buy existing companies in developing countries then they are injecting foreign capital and **increasing the aggregate demand**
* MNCs may improve the infrastructure of the economy, both physical and financial, or they may act as a spur for governments to do so, in order to attract them
* The existence of MNCs n a country may provide more choice and lower prices for consumers. They may be able to provide essential goods that are not available domestically
* MNC activities along with liberalized trade can lean to **a more efficient allocation of world resources**

\*Since 1978, China has actively tried to attract foreign investment as a way to stimulate economic growth. A significant proportion of China’s exports are produced by foreign firms. Through joint ventures with foreign firms, Chinese firms have grown rapidly and successfully and China itself is now the source of a large outflow of foreign direct investment. As China grows, so does its demand for raw materials and much of Chinese FDI abroad is its investment in natural resources.

**Syllabus item: 175 Weight: 5**

**Main idea 1**

Disadvantages associated with FDI

* MNCs often bring in their own management teams, simply using inexpensive low skilled workers for basic production and providing no education or training 🡪 **Limits the ability of host countries to acquire new technologies**
* It is argued that **MNCs have too much power**, because of their size, and so gain large tax advantages or even subsidies, reducing potential government income in developing countries. Also, too much power internationally. Their incomes and size allow them to exert too much influence on policy decisions taken in institutions such as the WTO
* Transfer pricing: developing countries with low tax rates encourage MNCs to invest reap little tax reward and developed countries also lose out on potential tax revenue 🡪 This represents **a potentially large loss of revenue to governments**. These are difficult to monitor and enforce, particularly for developing country governments
* It is argued that MNCs situate themselves in countries where legislation on pollution is not effective and thus they are able to reduce their private costs while creating external costs 🡪 **damage to environment**
* It is argued that **MNCs may enter a country in order to extract particular resources**, such as metals or stones, then strip those and leave
* MNCs may use capital-intensive production methods to make use of abundant natural resources 🡪 **will not greatly improve levels of employment** in the county. MNCs should use appropriate technology where production methods are aligned to the resources available
* In most cases, where MNCs buy domestic firms, the owners of the firms being bought are paid in shares (stocks) from the MNC 🡪 it is likely that the **actual money will never be used in the developing country’s economy**
* **MNCs may repatriate their profits**, which means that they transfer their profits out of the country back to the MNC’s country of origin