BENEFITS AND THREATS STEMMING FROM FOREIGN DIRECT INVESTMENTS FOR THE ECONOMY OF THE HOST COUNTRY

Magdalena Byczkowska[1]

Summary

Direct foreign investment play an important role in the economy of host country. It is said to be essential for economic development and comparative improvement thanks to technology import and opening the new markets. Direct foreign investment is connected with technology and methods of management transfer. However, such an investment made by international corporations aims to take over the control on the company activity.

Keywords: foreign direct investment, development, enterprise

Introduction

The migration of capital on the international scale is one of the important factors of developmental processes of the contemporary world economy. The intensification of the international capital circulation, with the particular emphasis on foreign direct investments, originates in economic development disparities in particular countries and regions of the world. Insufficient domestic capital resources, lack of modern technologies and methods of management find their outcome in the positive perception of the foreign capital, being a factor essentially influencing domestic structural transitions.[2] Because of its nature, the role of foreign direct investments is

[1] PhD., University of Applied Sciences in Gorzów Wielkopolski, Poland.

[2] See more: Czyrka K., *Innowacyjność a realia w zarządzaniu zasobami ludzkimi w lubuskich zakladach pracy chronionej- wybrane wyniki badań,* w: Funkcjonowanie regionalnego systemu innowacji w województwie lubuskim. analiza i prognozy red. A.Świedek, Zeszyt naukowy nr.1, Funkcjonowanie regionalnego systemu innowacji w województwie lubuskim, Analizy i prognozy, Zielona Góra 2012 and Kaczmarek A., *Park naukowo- technologiczny*

not solely limited to supplementing the internal accumulation of capital, but what is more, covers the transfer of knowledge, technology, skills, organizational and managing solutions. Along with the inflow of foreign investments, there are connected certain expectations. All of them boil down to the expected reviving impact of the foreign capital on developmental processes. This impact depends on both the scale of the incoming investments, mainly direct ones, as well as the structure of foreign direct investments in its broadest sense.[3]

We can highlight five potential areas of macroeconomic influence of foreign direct investments on the economy of the host country. They are: ***technology, job market, investments, balance of payments and national income.***

The effects of the inflow of direct investments

Entering of a foreign investor into the market of a host country will produce direct effects, also known as primal ones, and indirect and external ones.

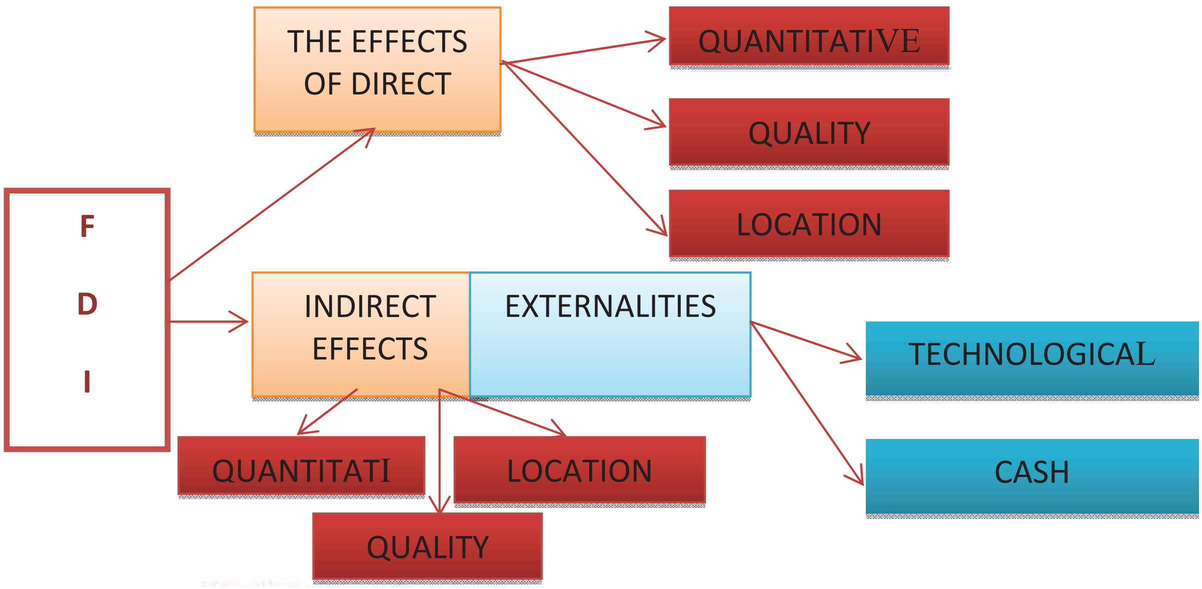
Primal effects are connected with the results which influx and implementing of foreign direct investments have on the receiving economy. The functioning of a foreign branch in the host country will also affect its economy indirectly through the interaction with other entities operating in it. Additionally, the activity of each company, including the one with foreign shareholding is connected with the rise of external effects. All kinds of foreign direct investments interactions in the host country may be of a positive or negative character. We can analyze them, however, using three approaches: *quality, quantitative and location effects.* Those dependencies are shown in Fig. 1.

---

jako narzędzie wspierania rozwoju małych i średnich przedsiębiorstw [w:] A. Bielawska (red. nauk.) *Uwarunkowania rynkowe rozwoju mikro- i małych przedsiębiorstw. Mikrofirma 2009*, WNUS Szczecin 2009.

[3] W. Karaszewski, J. Wiśniewski, Bezpośrednie inwestycje zagraniczne w Polsce: ich skala, struktura i wpływ na procesy rozwojowe *[Foreign Direct Investments in Poland, Their Scale, Structure and Impact on Developmental Processes],* EKONOMISTA 2000, No. 4, p.569

Figure 1 The effects of FDI inflows in the economy of the host country



Source: own elaboration based on the: J. Witkowska, Bezpośrednie inwestycje zagraniczne a rynek pracy, Ekonomista 2000/5, s.649.

The direct quantitative effect concerning the influx of foreign direct investments is the kind of primary interaction of direct investments in the economy of their location, whose size cannot be measured – cannot be subject to quantitative evaluation. Because of a foreign investor's activity there appear positive quantitative effects, connected for example with the improvement of efficiency of management and productivity of taken over companies, increase in capital, research and development expenditures, increase in export, terms of trade improvement owing to the lowering of costs of import, inflow of technologies, licenses, rise of salaries, etc.[4]

Apart from measurable effects, direct investments may also yield the ones whose measurement is obstructed. These are *direct quality effects.* To positive effects of quality character, which are connected with the influx of foreign direct investments we include, inter alia: introduction of new techniques of management, personnel training, creating environment protection standards at the workplace, transfer of modern knowledge and skills, improvement of the structure of import and export being the result of foreign companies' activity. Primal quality effects may also be negative, for example connected with: the increase of fear and instability of employees as a result of the entry of foreign investors into a given entity, stress accompanying inevitable learning of new behaviors, application of undesirable practice in

[4] J. Witkowska, Bezpośrednie inwestycje zagraniczne a rynek pracy *[Direct Foreign Investments, and a Job Market], Ekonomista 2000/5, p. 651*

employment, the risk of influx of "dirty" technologies to countries of lenient environment protection standards, risk of reserving workplaces of lower and medium level of management for the domestic workforce[5].

Referring the direct effects to the particular territorial entity of a given country, in other words – the particular location, lets us highlight primary location effects. These will be both quantitative and quality effects related to the given area of a country, for example the increase of a region in Gross Domestic Product of the given economy or its export.

Positive quantitative indirect effects are the result of relationships between foreign and domestic entities. They are connected with the influence of companies with foreign shareholding on the activity, profitability and scale of activity of local companies. Thus initiated multiplier mechanism accumulates positive quantity effects in economy. They are, for example: increase in demand generated by a foreign investor for produce and employment of contractors, increase in profit and as a result in budget income, improvement in local manufacturers' productivity, increase in export of domestic entities, being the consequence of cooperation with companies with foreign capital, etc.

Negative quantitative indirect effects will be connected with the avoidance of foreign entities of cooperation with the domestic suppliers and using imported supplies. This may result in diminishing of the scale of operation of local companies, strengthening competition and superseding less effective manufacturers, lowering of the budget income, increase in unemployment rate and drop in wages of employees working in industries being in crisis due to the inflow of foreign direct investments. The adverse impact of companies with foreign capital on the current account deficit can produce indirect effects such as the a necessity of its financing, for example from the national foreign currency reserves.

Indirect quality effects work on that to local entities permeate procedural patterns, new methods of management and organization, and that they purchase new technologies. Functioning of a foreign entity contributes to the fact that those behaviours permeate to the local business as a consequence of demonstration and learning. The degree to which indirect quality effects appear is determined by the level of:

- competition in the market in which local and foreign entities operate[6],
- workforce training and managing staff at the disposal,

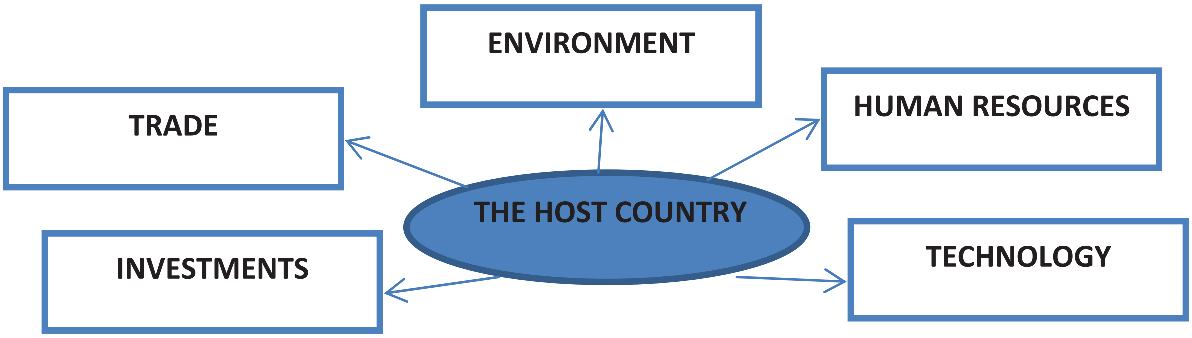
[5] A. Żywicka, *Rejestry przedsiębiorców w polskim systemie prawnym*, Zeszyty Naukowe WSEI, seria Administracja (1/2012) Lublin 2012, str. 83-94.

[6] A. Kokko, Technology, Market Characteristics and Spillovers, Journal of Development Economics, Vol. 43, 1994, p. 279 – 293.

– the foreign investor's requirements as to local suppliers, the higher ones, the higher pressure on assuming new methods of production organization and management.

If the highlighted indirect quality or quantitative effects appear in the local markets, given regions of a country, then they will be classified as **indirect effects of location.** The influence of foreign direct investments on the economy may be analyzed in the following spheres, as shown in Fig 2.

Figure 2. The impact of FDI on the economy of the host country



Source: own elaboration based on the: Transnational Corporations an Managment Division, in: World Investment Report 1992, UNCTAD, Geneva 1992.

Having summed up the theoretical deliberations regarding the effects of foreign investments inflow for the host country, it should be underscored that they can be both positive and negative. The kind and power of these effects to a large extent depends on conditions and the economic policy of the host country.

As the above theoretical considerations show the inflow of foreign capital in form of foreign direct investments is of vital importance for the host country. However, the analysis of the importance of foreign direct investments for the economy encompasses not only the financial facet of those investments, but also, as mentioned before, technological, organizational and marketing ones. Below has been presented the impact of the above-mentioned investments.

The influence of foreign direct investments on the competitiveness of economy and local environment

The influence of foreign direct investments on competitiveness in the country of location and local environment is diverse owing to the kind of the implemented investment. A firm assessment of relationships occurring between foreign direct investments and competitiveness and innovativeness of companies is not possible. The outcome of empirical research carried out around the world over the years has not confirmed the presence of both positive and negative consequences. This means that in particular situations such investments lead to the improvement in competitiveness and innovativeness of entities operating in the country of the recipient, and in others worsen them. For example, in transforming and developing countries have been observed in the markets of such countries as Mexico, Uruguay, Indonesia or Russia, and negative: Venezuela, Czech Republic or Lithuania[7]. The available results of research let as assume that the presence of foreign companies has fostered the access to technologies and acquisition of new marketing skills.[8] Another area of influence of foreign direct investments on the host economy is the way the companies of direct investment operate in the local environment. The scope in which direct investors build relationships with domestic entities and establish a network of contractors. The functioning of a foreign investor in the local environment facilitates the indirect effects. These effects are demonstrated, among others, within:

- the growth in productivity of local manufacturers,
- increase in their export,
- higher capital expenditures,
- dissemination of standards, etc.

Their exposure in the balance of payments of a country requires a longer time span. Because they are not of a direct character, it is difficult to estimate to what extent has their appearance been caused by the activity of companies with a foreign capital.

The impact of foreign direct investments on the transfer of technology, knowledge and skills

Technology as a object of the process of transfer within foreign direct investments affects the economies of the countries taking part in this process. It refers to both, the country of the investment exporter (native country of the transnational corporation) and the countries importing the investments (countries receiving foreign investors). Within the context of foreign direct

---

[7] M. Goryń (Edit.) Strategie firm polskich wobec ekspansji inwestorów zagranicznych *[The Strategies of Polish Companies Aginst the Expansion of Foreign Investors], PWE,* Warszawa 2005, p. 79.

[8] M. Bąk, P. Kulawczuk, Analiza wpływu inwestycji zagranicznych na polską gospodarkę *[The Analysis of Impact of Foreign Investments on the Polish Economy], PAIiIZ, Warszawa 1996.*

investments export, the transfer of technology from the native country of the transnational corporation does not produce any major criticism, because it does not affect its economic effects in a negative way. Especially if we have anything to do with a technology transfer of non-material nature (licenses, know-how), which has no impact on the depletion of resources and technological capacity of the country native to the transnational corporation. As far as developed countries are concerned, technological solutions implemented by foreign investors may be *substitutional* or *complementary* in relation to the technology used in the country of the investment importer, i.e. they are marked with higher quality and efficiency or can be applied in areas so far weakly penetrated by other (local) companies.

The importance of technology incoming from abroad is far greater in the case of underdeveloped countries, where lack of technology may be a bottleneck for the economic growth of the country. Many a time, there is a situation of domestic technological incapacity enabling implementing proper production processes. The acquisition of the appropriate technology from abroad may turn out to be a prerequisite to start up or accelerated the social and economic growth. The effect of technology transfer and the diffusion of technical solutions in the international environment is usually initiating the production in the market receiving foreign direct investments. The target of supplies of the manufactured goods can be not only this one market, but also – intentionally or unintentionally by the transnational corporation – the market native to the transnational corporation or third-party countries. Growing competition of the goods coming from the countries of low level of expenditures, which become a place of manufacturing export products, often raises fears in developed countries, being native countries for the transnational corporations. In relatively short time, there might be increase in penetration of such a market by cheaper imported products, which has disadvantageous impact on local producers. As examples we might give the supplies of products manufactured in Asian countries for the North-American and EU markets which are connected with the influx of foreign direct investments.

A feature of the growing number of contemporary transnational corporations is decentralization of part of R&D activities to foreign entities and seeking out new technological solutions, coming from local entities. In the case of R&D decentralization, there may happen a technology backflow from the country receiving foreign investments to the country native to the transnational corporations, and also a diffusion of technology in the whole corporate system on the international scale. This is a very beneficial phenomenon for both the transnational corporation and its native country. The transnational corporation obtains positive, the so-called external effects from investing abroad, including technological benefits connected with learning technical standards, obtaining new technological solutions, rising qualifications and acquiring technological knowledge by the personnel. From the point of view of the economy of the country exporting investments, at a relative low cost increases the supply and quality of the technology available in such a country.

The kind of investment many a time affects the character of the transferred technology and the effects of such a process for the country receiving foreign direct investments. Horizontal investments, aiming at selling in underdeveloped countries, are accompanied by the transfer of technology in the phase of maturity, and even already obsolete in the native country of the transnational corporation and other developed countries. Such technology, however, is sufficiently competitive in the country of location of the investment, so it must be properly protected in order to prevent its easy imitation by local companies.

The issue looks otherwise in the case of vertical investments, which at the point of initiation might be accompanied by far faster and intensive influence of the transferred technology on the technological capacities of the country receiving the investment. The arising cooperation links with other entities (with other transnational corporations or local companies) are supposed to ensure the supplies of various production factors of material and non-material character which are important from the perspective of the chain of values created by the whole transnational corporation. Their outcome is the appearance of technological support given to other entities cooperating with transnational corporations. In such a situation, we have to do with a relatively fast progressing process of innovation diffusion in the country accepting the foreign direct investments, particularly if the technological gap present existing between the transnational corporations and local suppliers is not that large.

On the other hand, we should have in mind the negative phenomena present in the host country for the foreign direct investments in the context of technology transfer. According to some, transnational corporations and the foreign direct investments they take up are a symbol of the new kind of colonization, based on technological and economical dominance of the developed countries over the underdeveloped ones. Specific R&D and utilizing the technological advances are oriented at the most attractive fields from the point of interest of transnational corporations, and not at the needs of the economy and society of the receiving country. Furthermore, the transfer of technology cannot meet the needs of the receiving country, e.g. due to excessive capital intensity, high licensing fees, fragmentary and specific character of technology, moral obsoleteness, etc.

Among the negative aspects of the foreign direct investments to the given country, we can mention their unstable character. The value of the investments' influx and their peculiarity are dependent on the objectives of transnational corporations and decisions made in them, on which the host country has little influence. The said instability of investments' influx causes difficulties in executing long-term programs of the economic development of a country.

It is noteworthy that the growth of competition in the domestic market with the participation of entities of transnational corporations, which have strong organization and strategic support of the headquarters, usually leads to the elimination of local goods and businesses. Taking key positions in the technology transfer may result in creating entrance barriers to numerous industries for potential competitors, which makes it difficult for local entities and minor economies attaining benefits from the international exchange. There is a possibility of the domestic market drain from new technological solutions, which will be utilized in the competitive production within the corporate network abroad instead of developing the export and production in the given country. Finally, we should mention a possibility of the formation of "enclaves" of modern and export-oriented production leading to the economically and socially disadvantageous dualisation of the economy acquiring investments, i.e. its division into sectors: modern and traditional (in the case of less-developed countries even underdeveloped) This produces the growth of economic polarization of regions of the country where the inflow of foreign direct investments is conspicuous and geographically concentrated.

The influence of foreign direct investments on the labour market

Foreign direct investments might interact with *the labour market and employment* affecting its: *growth*, *determining the efficiency of the workforce*, *and also stimulating pay rises.*[9] The level of interaction of the foreign direct investments on these parameters is dependent on the type of implemented investments. Capital intensive investments, such as for example investments in the sector of technology, require first and foremost the capital expenditure so their influence on the mentioned factors is not essential, and it boils down

[9] B. Domański (Edit.), Inwestycje zagraniczne w Małopolsce 2007 *[Foreign Investments in Małopolska 2007]*, Urząd Marszałkowski Województwa Małopolskiego *[Małopolskie Province Marshall's Office]*, Cracow 2008, p. 48

to employing a specialized team of professionals. Workplaces, however, are created in the case of labour consuming investments, where on a large scale are created vacancies for less-qualified workforce. The influence of foreign direct investments on the creation of workplaces in interconnected industries, such as transport, semi-products, raw materials supply or additional services is not insignificant. On the other hand, as a result of the foreign direct investment inflow, there appear potential dangers related to the job market, which can be visible, for example, in the employment decrease. Such a situation may happen in the case of redundancies in restructured companies, bankruptcies of domestic companies caused by pushing out from the market or using mainly foreign goods and services suppliers. As the reasons for the potential unemployment resulting from the influx of foreign direct investments, J Koćwin, enumerates such aspects as the following: [10]

- application of capital intensive techniques, and not work intensive;
- existence of large workforce resources in the country;
- application of unfair business practices by foreign companies which lead to the bankruptcy of domestic manufacturers,
- inability to meet high expectations of foreign employers by the local workforce,
- pressures to relax regulations in the job market,
- weakening of relationships between domestic companies and foreign ones, their suppliers and recipients.

The positive effect are mainly related to the foreign investors, who open new companies (branches of parent companies) in the country of location. As a result of investments they take up, in such a country begins forms the growth of net capital and new workplaces are created. The level of increase in demand for work mainly depends on such factors as the size of the executed investments or their branch-industrial structure.

The positive effects for the job market also crop up when there is cooperation between entities with foreign capital and local companies. The positive ones are also brought about by the creation of facilitating conditions by entities with the foreign capital which results in pay rise. It is noteworthy, however, that higher wages in the entities with the participation of foreign capital account for the migration of highly-qualified employees from local entities.

Yet, the negative effects of the foreign direct investments influence on the job market are related to the introduction of unwelcome practices

---

[10] J. Koćwin, Obszary oddziaływania bezpośrednich inwestycji zagranicznych na gospodarkę Polski w latach 1989-1998 *The Areas of Influence of Foreign Direct Investments on the Polish Economy In the Years 1989-1998]*, SGH *[Warsaw School of Economics]*, Warsaw 1999, p. 54.

by foreign investors, which are reflected by working time lengthening, employee benefits reduction and also erosion of wages in domestic companies, and their struggle for effective competing with foreign entities by reducing labour costs.[11]

The influence of foreign direct investments on commercial activity

An essential source of a positive impact of foreign direct investments on the economy, directly reflected in the balance of payments, is the foreign *commercial activity* carried out by means of a branch. When there is a favourable commercial policy and the proper infrastructure, companies with the foreign capital are able to utilize the abundance of resources of the host country to develop its export. Export facilitates creating new production opportunities in the country of location and the formation of positive indirect effects. The more technologically advanced the industry, within which have developed new streams of the international trade, the bigger they are. The benefit resulting from the entrance of a direct investor to the host country will be an opportunity to participate in foreign markets through the links of this entity. Such a situation takes place as a result of the access to the internal market of the corporation as such, as well as other, directly disconnected markets. The entrance into a foreign market under a renown brand of a foreign investor is easier than the attempts to export similar goods coming from national companies unknown in the international markets. This easier access also results from a distribution network owned by the direct investor abroad. The UNCTAD research show that foreign entities are more likely to export from local companies.[12] Their influence on the structure of trade towards the goods of higher technological advancement and added value is also important. However, import activity of the branch may contribute to the purchase of indispensable capital goods and means of production.

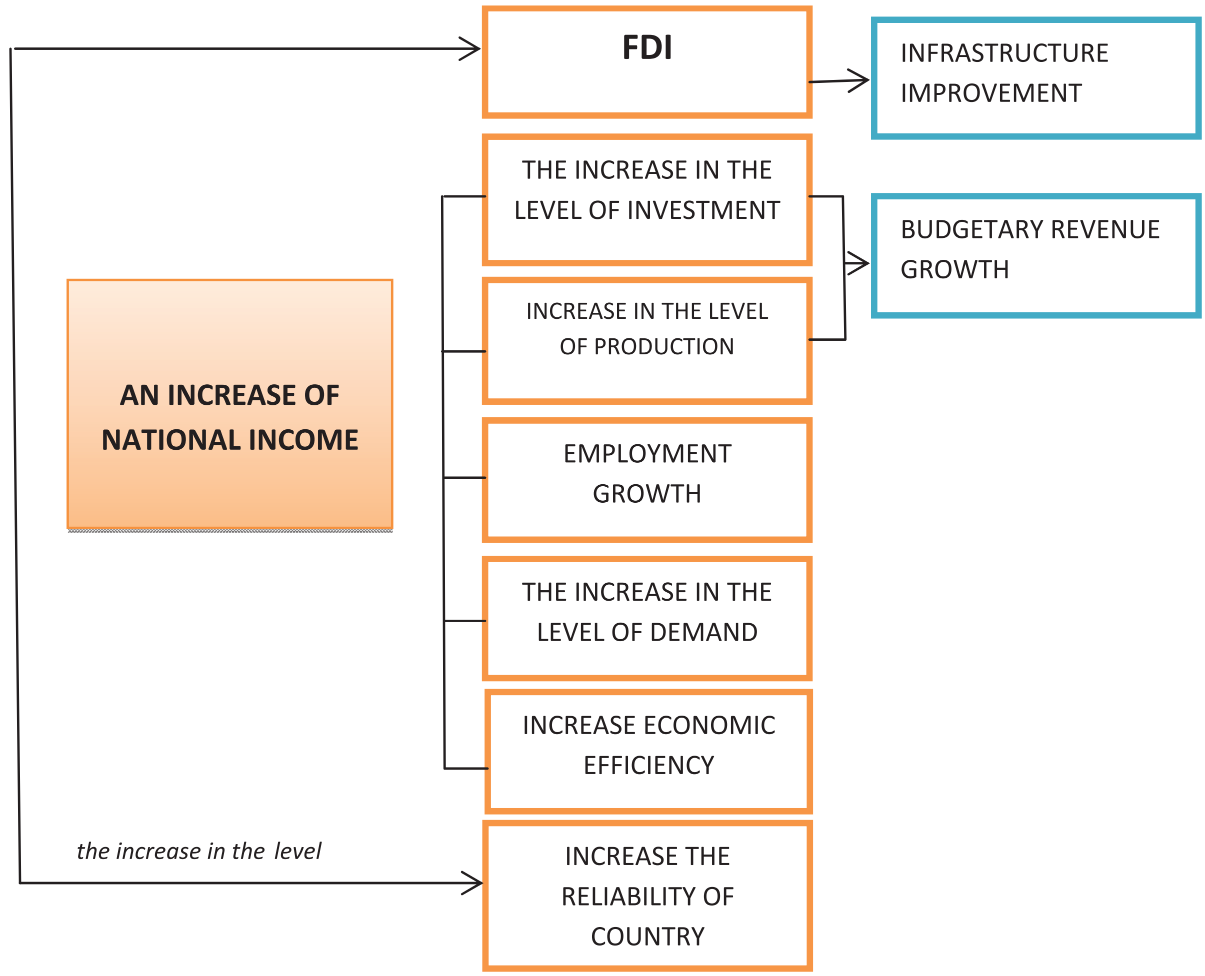
The influence of foreign direct investments on the *national income* is included to direct benefits that foreign investments bring. The growth of the national income causes the expansion of import, yet it is not directly reflected in the export increase. However, as Fig. 3 shows, the increase in

[11] K.A. Firlej, Wpływ bezpośrednich inwestycji zagranicznych na małopolski rynek pracy *[The Influence of Foreign Direct Investments on Małopolska Job Market]*, Cracow 2007, p. 116

[12] World Investment Report…, desc. Cit. P. 10.

income is followed by the growth in the production and employment in the economy. Part of this production may be earmarked for export. Ultimately, the growth of the national income is positive. If its increase is of a permanent character and correlates with the increase of the savings rate, at a certain level of investments it can diminish the gap of own resources and contribute to the improvement of the balance of payments.

Figure 3 The impact of FDI on host country national income



Source: own elaboration based on the M.Bąk, P.Kulawczuk, „Wpływ inwestycji zagranicznych na gospodarkę Polski", IBnDiPP, PAIZ, KJG, Warszawa1997, s. 32.

Conclusions

All in all, in literature we bring out five major areas of foreign direct impact on the receiving economy. Each of them is directly or indirectly reflected in the balance of payments of the country. The flow of capital and technology is included in the transactions of the capital and financial account. As technology may take form of the purchase of services, be embodied by commodities and present in form of a grant, its transfer will be recorded on the current account. The balance of payments directly encompasses export and import of entities with foreign capital. It has been found that direct investments also produce direct effects in the economy. They are not stated straightforward in the balance of payments as their disclosure, in principle, refers to a longer term. They are linked with, among others, the process of capital formation and the growth in productivity.

References:

1. Bąk M., Kulawczuk P., Analiza wpływu inwestycji zagranicznych na polską gospodarkę *[The Analysis of Impact of Foreign Investments on the Polish Economy], PAIiIZ, Warszawa 1996.*
2. Czyrka K., *Innowacyjność a realia w zarządzaniu zasobami ludzkimi w lubuskich zakładach pracy chronionej- wybrane wyniki badań,* w: Funkcjonowanie regionalnego systemu innowacji w województwie lubuskim. analiza i prognozy red. A. Świedek, Zeszyt Naukowy nr 1, Funkcjonowanie regionalnego systemu innowacji w województwie lubuskim, Analizy i prognozy, Zielona Góra 2012.
3. Domański B. (Edit.), Inwestycje zagraniczne w Małopolsce 2007 *[Foreign Investments in Małopolska 2007]*, Urząd Marszałkowski Województwa Małopolskiego *[Małopolskie Province Marshall's Office]*, Cracow 2008.
4. Firlej K.A., Wpływ bezpośrednich inwestycji zagranicznych na małopolski rynek pracy *[The Influence of Foreign Direct Investments on Małopolska Job Market]*, Cracow 2007.
5. Goryń M. (Edit.) Strategie firm polskich wobec ekspansji inwestorów zagranicznych *[The Strategies of Polish Companies Aginst the Expansion of Foreign Investors], PWE,* Warszawa 2005.
6. Kaczmarek A., *Park naukowo- technologiczny jako narzędzie wspierania rozwoju małych i średnich przedsiębiorstw* [w:] A. Bielawska (red. nauk.) *Uwarunkowania rynkowe rozwoju mikro- i małych przedsiębiorstw. Mikrofirma 2009*, WNUS Szczecin 2009.
7. Karaszewski W., Wiśniewski J., Bezpośrednie inwestycje zagraniczne w Polsce: ich skala, struktura i wpływ na procesy rozwojowe *[Foreign Direct Investments in Poland, Their Scale, Structure and Impact on Development Processes],* EKONOMISTA 2000, No. 4.
8. Kokko A., Technology, Market Characteristics and Spillovers, Journal of Development Economics, Vol. 43, 1994.
9. Koćwin J., *The Areas of Influence of Foreign Direct Investments on the Polish Economy In the Years 1989-1998]*, SGH *[Warsaw School of Economics]*, Warsaw 1999.
10. *Transnational Corporations an Management Division, in: World Investment Report 1992, UNCTAD, Geneva 1992*.
11. Witkowska J., *Bezpośrednie inwestycje zagraniczne a rynek pracy, Ekonomista 2000/5.*
12. Żywicka A., *Rejestry przedsiębiorców w polskim systemie prawnym*, Zeszyty Naukowe WSEI, seria Administracja (1/2012) Lublin 2012.