International Journal of Physical and Social Sciences

(ISSN: 2249-5894)

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December 2011 IJPSS Volume 1, Issue 4 ISSN: 2249-5894

Title

FDI IN EMERGING MARKETS

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Abstract:

Among the different forms of capital flows, academics and policymakers, talk about foreign direct investment (FDI) the most. This is because of several benefits of FDI and its importance in the world economy vis-à-vis other forms of capital flows. In the past fifteen years, FDI has been the dominant form of capital flow in the global economy, even for developing countries. FDI now have turned up their route towards emerging economies. Emerging markets are clearly outperformed by developed countries, and the disparities among countries are stark. While the world average was $115, it was $505 for developed countries and $49 for emerging markets .The paper studies the changes in the pattern of FDI and which have been diverted towards emerging economies.

Keywords: Foreign direct investment, Emerging economies, India, China.

1. Introduction:

Emerging markets are nations with social or business activity in the process of rapid growth and industrialization. Currently, there are 28 emerging markets in the world, with the economies of China and India considered to be by far the two largest. Examples of emerging markets include China India, some countries of Latin America (particularly Argentina, Brazil' Chile, Mexico, Colombia and Peru), some countries in Southeast Asia, most countries in Eastern Europe, Russia, some countries in the Middle East (particularly in the Persian Gulf Arab States), and parts of Africa (particularly South Africa). In the 2008 Emerging Economy Report 'The Center for Knowledge Societies defines Emerging Economies as those "regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization." It appears that emerging markets lie at the intersection of non-traditional user behavior, the rise of new user groups and community adoption of products and services, and innovations in product technologies and platforms.

Emerging Economies are those regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization. This framework allows us to explain how the non-industrialized nations of the world are achieving unprecedented economic growth using new energy, telecommunications and information technologies**. The**

Emerging Economy Report is an essential tool for business innovation. It focuses on India, China, Indonesia, South Africa, Kenya, Egypt and Brazil. It uses diverse methodologies and different kinds of data to build the world's most comprehensive planning tool for corporate strategy, marketing and product and service innovation. According to World Bank (1992),emerging economies are Hungary, Czech Republic, Poland, Slovakia, Romania, Slovenia, Estonia, Lithuania, Latvia, Russia, Belarus, Ukraine, Greece, Turkey, Republic of Korea, China, Malaysia, Thailand, Indonesia, Philippines, Vietnam.

Since the beginning of the 1990s foreign direct investment (FDI) has become the most important source of foreign capital for emerging market economies (EMEs). Official flows have lost much of their erstwhile significance, while bank lending has been muted since the debt crisis of the 1980s. Portfolio investments have grown notably, but tended to be quite volatile. In particular, they have decreased markedly in the aftermath of the Asian crisis of 1997-98. In contrast, FDI flows to emerging markets continued to increase over the nineties. Indeed, after the Asian crisis positive net private capital flows to emerging markets persisted only because of substantial FDI activities.

The increasing reliance of emerging markets on FDI is often seen as an extremely welcome development. Many positive implications are ascribed to these particular capital transfers that apparently set them apart from other types of private capital flows. The import of improved management techniques and of more advanced technologies as well as the related easier access to international financial markets is among the commonly cited advantages associated with FDI. In addition, FDI is also expected to be a relatively stable long-term commitment on behalf of a multinational enterprise (MNE). All this together should have significant benefits for the recipient countries in terms of economic growth and reduced external vulnerability.

Especially, even large current account deficits are often viewed as clearly sustainable as long as they are largely financed through FDI instead of bank lending or portfolio investments, which are both known to be highly volatile. This sanguine mainstream view of FDI has recently been increasingly questioned. Doubts have been expressed as to whether the positive effects of FDI have perhaps been exaggerated and the longer-term stability assumptions of FDI really conform to reality. A review of the available evidence suggests that FDI may indeed possess the above mentioned desirable features, but that their realization depends on a combination of other factors that need to supplement direct investment activities. Moreover, the volatility of FDI can be significantly higher than commonly thought. Also, acquisitions by non-residents of utilities and other public enterprises could help prolong unsustainable macroeconomic policies. Under the circumstances, the benefits of importing know-how would fade against the country's hidden increase in its external vulnerability. While such risks call for a qualification of the previously rendered positive assessments, they do not seem to necessitate a comprehensive reappraisal of the role of FDI.

2. Literature survey:

Most emerging market economies (EMEs) have been experiencing staggering economic growth rates, especially over the past decade. The academic literature has sought to obtain a better understanding of the main drivers of rapid economic development in the benefiting countries, or the lack thereof in those developing countries with either negligible. Emerging economies consider Foreign Direct Investment (FDI) to be an important among **e**merging economies. In doing so, it reveals especially important part of the transition the risks most significant in determining levels of FDI economic growth largely because FDI can act as a flowing into them, it technology, management, access to foreign markets, and financial resources. Emerging economies consider FDI to be among emerging economies via policies and programs designed to attract FDI (Amirahmadi are reviewed. and Wu, 1994; Peitsch, 1995**).**

FDI inflows to south, south-east and east Asia grew rapidly during the 1980s and accelerated further in the 1990s.During 1981-85, south, south-east and east Asia received about a quarter of total FDI inflows to developing countries. In the next five years, 1986-90, the share of this region was much higher at about 53 per cent. In recent years, this region has been receiving over 60 per cent of the total FDI inflows to developing countries. A large part of the increase in FDI inflow to China is from Hong Kong. A high proportion of FDI in China is believed to be 'round-tripping' type, i e, capital originating in China, flowing to Hong Kong and re-entering China FDI inflows to south, south-east and east Asia grew rapidly in the 1980s, and have grown at an accelerated pace in the 1990s. In 1995, FDI inflows to this region accounted for about two-thirds of total FDI flows to developing countries. The flow of FDI in Asia has shifted over time from Asian NIEs to ASEAN, and further to China. With rising wages and currency appreciation, Asian NIEs have lost their attractiveness as a destination for FDI flows.(Bishwanath Goldar Etsuro Ishigami, 1999).

As one of the world's fastest growing economies, China has attracted a large amount of foreign direct investment (FDI) over the last two decades and, since 1993, has been the largest FDI recipient amongst the developing countries. The amount of FDI inflows into China totaled $US488 billion1 during the period 1988-2003, with approximately 271,963 multinational enterprises (MNEs) operating in China. Does this enormous amount of FDI in China crowd out domestic investment or complement it? Answering this question is important because a complementing relationship means a beneficial effect of FDI on growth irrespective of time horizons. Otherwise, FDI may be detrimental to economic growth in the long run, if not in the short run. Attracting FDI has been a key pillar of China's 'opening up' policies and economic reforms. In the early 1980s, special economic zones were formed with preferential policies including tax concessions and special privileges for foreign investors. During the reform period, the Chinese government has developed various new legislations to improve investment conditions and the business environment in order to attract FDI.(Sumei Tang,1 E. A. Selvanathan and S. Selvanathan,2008)

The period since the beginning of 1990 witnessed an immense upward shift in the level of capital inflows to EMEs. The years from 1990 through 2002 can nevertheless be grouped into two distinguished phases. The first phase lasted until the Asian crisis erupted in 1997 and was characterised by a steep increase in both FDI and portfolio investments. Bank lending and trade credit were rather volatile, but on the whole increased as well .The second phase was characterised by a sharp downward correction in total capital inflows, followed by a recovery since 2002. Looking at the development of the individual categories of capital flows to EMEs during this second period, it is striking that FDI actually increased until 2001 and has fallen only slightly since then. The picture is completely different for portfolio investments and bank lending as well as trade credits, all of which have shown significant retrenchments. The most recent recovery in total inflows can thus be attributed to the strength of FDI activities, while the net

Out flows in other categories of the EMEs' capital account have slow down. The upward shift in the average level of inflows since the beginning of the 1990s has mainly reflected substantial progress in proceeding with economic reforms in the recipient countries. With the demise of central planning regimes many EMEs increasingly adopted market-oriented and stability-oriented policies associated with the concept of the "Washington consensus". (Deutche Bundebank, 2003). Foreign direct investment in emerging economies is booming after a temporary setback in 2001-04. Foreign investors seek local markets and export platforms based on local resources such as low cost labour or natural resources. Most investors pursue market-seeking objectives, yet resource-seeking investors account for many large projects, given them a large weight in many measures of FDI. Initially, many investors may be motivated by only one of the objectives, but most investors over time develop a range of activities and serve both domestic and export markets.(Klaus E Meyer, 2005)The impact of FDI on host economies is complex as foreign investors interact with, and thus influence, many local individuals, firms and institutions.

The eclectic paradigm of Dunning (2001) hypothesizes that firms make their international production decisions based on perceived ownership (O advantages), location (L advantages) and internalization (I advantages) related factors. When stretched from the micro to the macro, this leads to the concept of the investment development path (IDP). As a country develops, the attractiveness of its OLI advantages change for potential investors (both inward and outward) and the country is likely to go through five relatively well-defined stages. most of the FDI inflows to India came from the original neighborhood (US, UK and Germany). Interestingly, Mauritius is the second largest source of FDI inflows to India in recent times. One possible explanation for the dominance of Mauritius is the double taxation treaty between the two countries, which favors routing of investment through this country. Perhaps Indian policy-makers responded positively to the role being played by overseas Indians (or persons of Indian origin in Mauritius). It can also be seen that the inflows from Japan, UK, the Netherlands, and Germany steadily increased during the later periods. Since 1991, India has encouraged foreign investment in infrastructure but the demand for infrastructure services is still not being met. This has been blamed on skewed investments in terms of concentration in consumer durable sectors (which is quick yielding and where withdrawal is easy) as opposed to infrastructure (investment of long-term nature and amounts needed are high). Arindam Banik, Pradip K Bhaumik, Sunday O Iyare , 2004).

James P. Lewandowski (1997) in his paper tests the -levels of investors' risks, by type, and flows of FDI Emerging economies consider FDI to be an among emerging economies. FDI inflows to south, south-east and East Asia grew rapidly in the 1980s, and have grown at an accelerated pace in the 1990s. In 1995, FDI inflows to this region accounted for about two-thirds of total FDI flows to developing countries. The flow of FDI in Asia has shifted over time from Asian NIEs to ASEAN, and further to China. With rising wages and currency appreciation, Asian NIEs have lost their attractiveness as a destination for FDI flows. Rather, these countries have become an important source of FDI flows for the region. (Bishwanath Goldar,Etsuro Ishigami, 1999**)**

3. FDI in Emerging Markets:

Regional integration is often considered a means to improve member countries' attractiveness to foreign direct investment (FDI). But regional integration agreements (RIAs) as well as FDI are too diverse to allow for generalized verdicts. Our case studies on Mercosur in Latin America, ASEAN and SAARC in Asia, and SADC in sub-Saharan Africa caution against high expectations in several respects. First, country-specific factors were often more important as a stimulus to FDI than regional integration per se. Second, member countries are unlikely to equally share RIA-induced FDI inflows, even though the larger and richer members are not necessarily the winners taking all. Third, the regional heavyweights Brazil, China, India, and the Rep. of South Africa have played a minor role so far in fostering effective regional integration through outward FDI.

Foreign Direct Investment has contributed very significantly to the process of growth of activity and trade in developing countries. The increasing mobility of capital and the rise of important enterprises and projects in the developing world have accelerated the process. The massive increase of FDI in developing countries is illustrated also in Table 1which shows the increases observed from 1990 to 2010.With over $400 billion, FDI flows to emerging markets reached an all-time high in 2005; flows are expected to stay at that high level until the end of the decade (**Table 1).** The share of emerging markets was an average of one-third of world FDI inflows during the past ten years (l996-2005), and this share, too, is likely to remain fairly stable during the next five years. In 1990 FDI flows were 38 US million dollars which increased to 408 in US million dollar in 2005 and then to 428 US million dollar in 2010. When se see the FDI stocks in emerging economies we find that it was 373 US million dollar in 1990 which increased to 3287 US million dollar in 2005and then to 5540 US million dollar in 2010.

Table 1. World FDI flows and stocks by region, 1990-2010
(Billion US dollars)

Region	1990	1995	2000	2005	2010
World					
Flows	202	340	1410	916	1407
Stock	1789	2766	5803	10130	16560
Developed countries [a/]					
Flows	164	206	1112	508	979
Stocks	1416	2036	3879	6843	11020
Emerging markets [b/]					
Flows	38	134	298	408	428
Stock	373	730	1925	3287	5540

Source: UNCTAD (www.unctad.org/fdistatistics) for 1990-2005 data; Economist Intelligence Unit and Columbia Program on International Investment, *World Investment Prospects to 2010: Boom or Backlash?* (London: EIU and CPII, 2006) for 2010 data.

4. The implications of FDI for emerging market economies:

Foreign direct investment in emerging economies is booming after a temporary setback in 2001-04. Foreign investors seek local markets and export platforms based on local resources such as low cost labour or natural resources. The most obvious effect of FDI on the growth potential of host countries may be the provision of additional capital. The inflow of foreign funds can help overcome the pervasive investment-saving gap, thus enabling countries to grow faster without sacrificing current consumption. By attracting foreign venture capital, the growth potential could be raised without incurring the vulnerabilities typically associated with external debt burdens. In addition, the investment by one MNE in a foreign firm can induce other MNEs to invest in the same host country as well in order to retain a role as a supplier of intermediate products. Moreover, MNEs usually enjoy better access to international financial markets than firms based only in the host economy. Also, a positive effect on the saving gap can be expected if the MNE is seen as an attractive investment opportunity by local residents or firms. Estimates have put this latter effect at one extra US dollar of domestic investment for every US dollar invested by an MNE, which substantially exceeds estimates for the effects of portfolio flows or bank lending.26 Furthermore, FDI may have a positive influence on the development of the local stock market if foreign firms were to recover part of the investment by selling equities in the host country. Additionally, the liquidity of stock markets is increased if foreign investors choose to purchase existing equities of the local firm as part of the investment.(2003, Deutche Bundersbank)

Many policy makers and academics contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort. In addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. In a recent survey of the literature, Hanson (2001) argues that evidence that FDI generates positive spillovers for host countries is weak. In a review of micro data on spillovers from foreign-owned to domestically owned firms, Gorg and Greenwood (2002) conclude that the effects are mostly negative. Lipsey (2002) takes a more favorable view from reviewing the micro literature and argues that there is evidence of positive effects. Surveying the macro empirical research led Lipsey to conclude, however, that there is no consistent relation between the size of inward FDI stocks or flows relative to GDP and growth. He further argues that there is need for more consideration of the different circumstances that obstruct or. promote spillover.

A few stylised facts point to an accelerating pace of financial development since the late 1990s in most EMEs, suggesting that some of them may even have started a process of financial "catching up" towards mature economies: First, the ratio to EMEs' gross domestic product (GDP) of their total external and domestic funding – defi ned as stock outstanding of private bank loans and debt-equity securities. Second, EMEs have been reducing their issuance of external debt since 2003, relying more on domestic debt – a process that has contributed to lower vulnerability to external shocks. Third, whilst of course starting from much lower levels, in the past decade the funding of EMEs in domestic markets has been increasing at a much faster pace than in G3 economies (defined as United States, EU14 and Japan) (Ettore Dorrucci, Alexis Meyer-Cirkel, 2009).Foreign direct investment (FDI) is prized by developing countries for the bundle of assets that multinational enterprises (MNEs) deploy with their investments. Most of these assets are intangible in nature and are particularly scarce in developing countries. They include technology, management skills, channels for marketing products internationally, product design, quality characteristics, brand names, etc. In evaluating the impact of FDI on development, however, a key question is whether MNEs crowd in domestic investments (as, for example, when their presence stimulates new downstream or upstream investments that would not have taken place in their absence), or whether they have the opposite effect of displacing domestic producers or pre-empting their investment opportunities.

The role of multinational enterprises (MNEs) in emerging economies has become a key aspect of contemporary disputes over the merits of globalization (Moran, 2002; Bhagwati, 2004).n Adversaries of globalization see MNEs as the culprits of many of the failures of the global economy, from persistent inequality, to sweatshop working conditions and to environmental degradation. Proponents of MNEs, on the other hand, point to many benefits that global economic exchange and foreign investment may bring, from lower prices to consumers, to knowledge transfer to emerging economies, and the spread of modern values and management practices.(Klaus E Meyer,2005)

5. CONCLUSION:

World FDI flows have recovered considerably since their drop from an all-time high in 2000. Emerging markets, in particular, have attracted record amounts of such investment, and, in that sense, have done well. Yet, this investment is unevenly distributed across regions and countries. Moreover, and most importantly, if FDI inflows are seen in relation to need – need for investment of all kinds to promote growth and development – as measured by FDI inflows per capita, emerging markets are not doing well at all: on average, developed countries attracted ten times more FDI per capita during the period 2001-2005. Moreover, the distribution is starkly uneven: the performance of the ten developed countries that have done best (Belgium, France, Finland, Iceland, Ireland, Luxembourg, Netherlands, Sweden, Switzerland, and United Kingdom) during 2001-2005 is over 4,000 times better than that of a group of the ten emerging markets that have done worst (Afghanistan, Bhutan, Cameroon, Central African Republic, Comoros, Cuba, Malawi, Nepal, Palestinian Territory, Rwanda). Even if the group of well-performing developed countries is compared with the largest emerging markets, the BRICs

(Brazil, Russia. India, China), the former still receive 38 times more FDI than the latter on a per capita basis.

Moreover, most of the emerging markets that do relatively well as far as FDI per capita is concerned are either natural resource producers or small tourism islands. While FDI in natural resources and tourism creates great opportunities to benefit potentially, deliberate efforts must be made (as discussed above) to build on these advantages if sustained and substantial development gains are to follow. For all other emerging markets, the challenge is to attract more FDI, especially by improving the business climate (which is, after all, to the advantage of domestic firms as well) and seeking to attract the kind of FDI that is most conducive to development. In addition, when countries have scarce resources for investment promotion, they need to focus at least part of them on attracting the kind of FDI that has maximum development effects. To be successful, such a targeted investment promotion strategy needs to be pursued within the framework of an overall development strategy (be it at the national, provincial or city level), because only such a strategy can provide the guidance that investment promotion authorities need for a targeting approach. Our analyses reveal interesting insights that explain foreign investment inflows to countries, both developed and developing. The approach in the form of neighbourhood and extended neighbourhood is deepening and widening our understanding of

FDI flows.

The recent boom in trade and investment flows among Emerging Economies is one of the most noteworthy recent events in the international scene. Trade flows among developing countries have grown at a much more rapid pace than overall trade, as the process of development brought about increasing synergies, supplemented by significant capital flows. While the adaptation of institutions has played an important role in paving the way, economic growth has been related to the emergence of developing Asia, the opening of regional economies, the increased availability of financing in the world- even at present- and the development of a modern and aggressive business elite in many of the larger developing countries, and particularly in Asia.

In this context we should discuss that to what extent can the current trends in trade and investment among Emerging Economies be considered sustainable over the medium term? While changes in Asia are clearly here to stay, is that the case for other regions or is it the consequence of a temporary investment boom in China and India, but which has not changed economic structures in Africa and Latin America?

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