

## **The Contribution of Foreign Direct Investment into Home Country's Development**

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### **Abstract**

*Global foreign direct investment (FDI) trends are likely to modify during the period 2004-2007. FDI has promoted to effective economic growth in a number of developing countries and the role of the foreign direct investment in this field has been extensively known in China and India, the world's two most populous growing economics have been using FDI as a stimulus in the growth process. For several decades FDI and economic growth have relationship which it has been a topical issue in policy market. Policymakers in a large number of countries are engaged in creating all kind of incentives (e.g. export processing zones and tax incentives) to attract FDI, because it is proposed to affect local economic development positively. Many countries have regarded FDI increasingly as contributing to their development strategies for the technology and capital it applies, and therefore have made to compete for FDI. Policies about investment have become liberal at the national and regional level, but scientists still do not find the comprehensive framework for FDI at multinational level. Home countries are hoping to push FDI into developing countries using guarantee funds and match marketing. There is optimistic view about the medium prospects for FDI that are explained in number of reasons. Broadly speaking, FDI has positively impact on economic growth, domestic market and international trade. These consider as the ongoing global trend towards the better business environment, and the search for competitively priced skills; and sharper global competition pushing companies to find lower cost destination. Generally, most host and home governments will tend to go on encouraging FDI.*

**Keywords:** Foreign Direct Investment (FDI), Domestic markets, international trade, economic growth.

### **1. Introduction**

Global foreign direct investment (FDI) trends are likely to modify during the period 2004-2007. Actually, direct investment related to the aim of getting a last interest by a resident of an economy that person has been known as a direct investor in enterprise which is resident in author economy named as the direct investment enterprise. FDI has the various effects on the aspects of global economic that can be categorized such as domestic market, international trade and economic growth. Over the past 20 years, FDI flows dramatically increase in many countries and it shows the clearest signs of the globalisation of the world economy (Busse and Groiozard, 2005), in addition, according to the World Bank in 2005, total FDI flows increased from some US \$55 billion in 1958 to US \$1.511 billion before falling back to US \$573 billion in 2003.

FDI has promoted to effective economic growth in a number of developing countries and the role of the foreign direct investment in this field has been extensively known in China and India, the world's two most populous growing economies have been using FDI as a stimulus in the growth process. Endogenous growth theory underlines the role of science and technology, Human capital and externalities in development of economic. The growth theory is concord with the increasing trend of globalisation and integration in the world economy. Export and FDI have played a crucial role in this process. Because these three items included FDI, export and economic growth have triangular relationship (Chang and Hsu, 2004).

From World War II through the 1970, in many countries especially developing ones, foreign directly investment faced resentment, because the host governments believed that FDI hurt local economies but since the late 1970s, the attitudes toward FDI changed. Generally, the impact of FDI on the local economy remains an important determinant affecting the FDI policy of the host government.

Among many scientists, there is a common question about FDI and domestic investment; "does FDI crowd in or crowd out domestic investment in a developing country". Crowding in means the development and upgrading of domestic firms to benefit from linkages with foreign affiliates, increases the efficiency of production, and contributes to the dissemination of knowledge and skills from multinational enterprises to the local enterprise section. It also reckons new investment in upstream and downstream production by other foreign or domestic producers or rises in financial intermediation. On the other hand, access to finance and skilled labour define the form of crowding out. This can increase cost to local company in terms of finance and skilled personnel (Kumar, 2003). Many researches attempt to clarify the answer. However, some results seem to be ambiguous and inconclusive.

In a research on three regions, namely Africa, Asia and Latin America using annual data covering 1970-96 done by Agosin and Mayer (2000), showed that there is strong crowding in of domestic investment by FDI in Asia and Africa. Yet crowding out is the evidence in Latin America. Kim and Seo (2003) used time-series estimation techniques for detecting the dynamic relationship among inward FDI economic growth and domestic investment in South Korea for the period 1985-99. They conclude that FDI is conceived as an organic as a merger of capital, technology, and management. By the raising consolidation of the global capital market and the development of domestic capital markets in many host countries of multinational enterprises (MNEs), capital markets in many host countries MNEs to the host countries seems to have become the least significant ingredient of FDI.

The cycle behaviour of business has been comparatively synchronized since the mid-nineties. Over 30 years, across the industrialized economies, in 2001, the dispersion of economic growth rates felled to its lowest level, as the global economy experienced a downturn that was unusually wide-spread across countries. Generally, the detected degree of output co-movement manifests both the nature of the shocks that have happened and the degree of economic interdependence. Output developments will be more corresponded if common shocks occur to be predominant, while they will be more asymmetric if idiosyncratic shocks are most important. Actually, it is associated to the economic relations among economies; country specific shocks may get transmitted to the other countries, improving output co-movement indirectly. In recent years, the higher rank of output co-movement has partially been ridden by common shocks, like a large alter range of oil prices, the increase and decrease of the information technology boom and restrictive monetary policies (Peersman 2002).

There are three dimensions in the rise of international economic interdependence; the first is about goods and services that is the traditional channel through which economies may affect each other. Although imports and exports as a share of GDP have in general increased, there has been no marked across-the-board acceleration of this flow recently. The financial asset is the second type of link which is provided by international trade, such as equity and bonds and cross border credit relations. For example in investigation in 2001 with Giver, Lee and Warnock explained that foreign holding of US long term securities amounted to 42% of US GDP in March 2000, having tripled in less than 2 ½ years. Over the last twenty years, association between stock markets of the major countries have greatly raised with except of Japan (Goetzmann, Li and Rouwenhorst 2001, Berben and Jansen 2002). The third aspect of interdependence is the internationalization of production on FDI. Since the late 1980, FDI has grown at rates far beyond those of international trade or output. In ten years from 1990 to 2000, the global stock of FDI more than doubled from 8.3% to 17.5% exceptionally (UNCTAD 2002).

There is optimistic view about the medium prospects for FDI that are explained in number of reasons. Broadly speaking, FDI has positively impact on economic growth, domestic market and international trade. These consider as the ongoing global trend towards the better business environment, and the search for competitively priced skills; and sharper global competition pushing companies to find lower cost destination. Generally, most host and home governments will tend to go on encouraging FDI (Table 1).

To organize ideas, we first examine the literature which explains the determination of FDI and global effects. Then discussing about FDI impact on economic growth in some countries around the world and fluctuation trend of economic effected by FDI. In addition, another aspects of FDI impact related to the domestic market, in this field we investigate that how domestic market which organized with foreign investment, make profit for host countries (Table1&2). We then investigate the external factors that are likely determination and magnitude of FDI by multinational enterprise. These letter determinations of FDI in international trades like trade flows,finding the larger issue of the quite varying incitation for FDI which impact on all aspects of exchange rates and taxes that are some parts of important item in international trade.

**1.1. The Benefits of FDI**

**Table 1: Benefits & costs to home country (Zhang,2001)**

Benefits	Costs
Stream of income from foreign earnings	Balance of payment: <ul style="list-style-type: none"> <li>✓ Initial capital outflow (but often set off by future stream of foreign earnings)</li> <li>✓ Current account suffers if FDI is to serve home market from low-cost production location</li> <li>✓ Current account suffers if FDI is a substitute for direct export</li> </ul>
FDI may import intermediate goods or inputs for production from the home country, creating jobs	
MNEs may learn skills from exposure to foreign countries	Employment effects: <ul style="list-style-type: none"> <li>✓ FDI a substitute for domestic production (e.g., Etch-A-Sketch)</li> </ul>

**Table 2. FDI: Benefits to host country (Zhang,2001)**

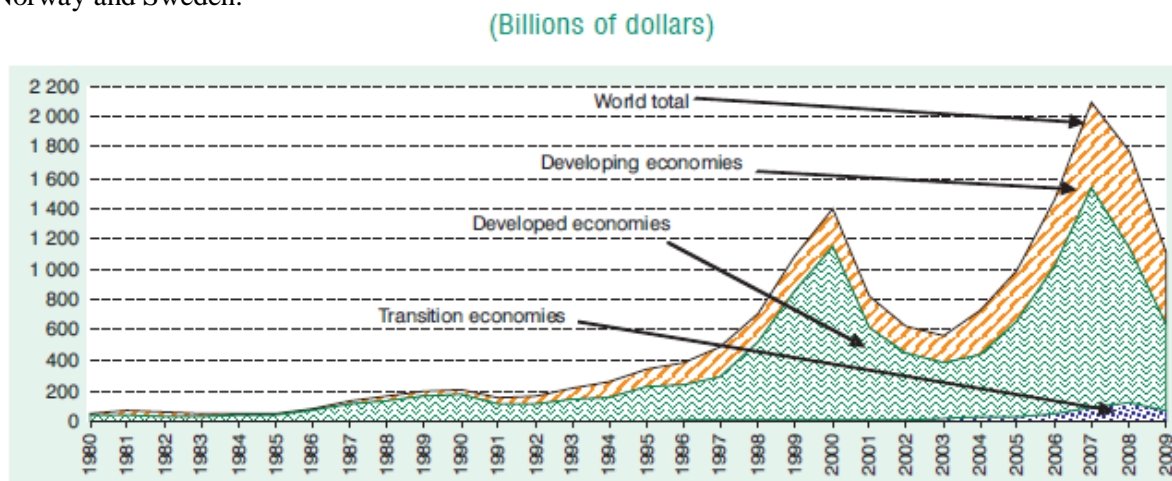
Resource Transfer Effects	Capital <ul style="list-style-type: none"> <li>✓ MNE invests capital in foreign markets</li> </ul> Technology <ul style="list-style-type: none"> <li>✓ Research supports that MNEs do transfer technology when they invest in a foreign country</li> </ul> Management <ul style="list-style-type: none"> <li>✓ When MNEs invest and manage in a foreign country, they often transfer management skills to the host country’s workforce</li> </ul>
Employment Effects	MNEs, by investing in foreign countries, can create employment opportunities for the local workforce But: Acquisition vs. Greenfield Investment
Balance of Payment Effects	Balance of Payment: A country’s balance-of-payment is the difference between the payments to and receipts from other countries FDI can have beneficial and negative effects on a country’s balance of payment. We look at the beneficial effects next
Effect on Competition	Efficient functioning of markets require adequate level of competition between producers
Initial Capital Inflow	When a company invests in a foreign country, it brings capital into that country
Substitute for Imports	To the extent that the goods/services produced by the FDI substitute for imported goods/services, there is a positive effect on B-of-P
Inflow of payments from export of goods and services	To the extent that the goods/services produced by the FDI are exported to another country, there is a positive effect on the host country’s B-of-P

### 1.2. Determination of FDI

There are some important reasons why a company want to introduce as a multinational firm. According to the Shatzand Venables findings in 2000, one reason to better the local market and the other is to get lower-cost inputs. FDI to apply local markets is often called “horizontal” or “market-seeking” FDI since it normally involves building duplicate plants in a foreign location to supply the market there. Reducing the cost involved in supplying the market such as tariffs or transport costs can be provided by the motivation or to become more competitive in other ways- such as through proximity to the market and being able to respond to changing local circumferences and preferences. If the cost of market access through exports like tariffs and transport costs are higher than the net cost of setting up a local plant ,exports should be replaced that is function of the horizontal FDI . In addition, horizontal FDI will be more probably supersede exports the larger the local market is- for two reasons. First, the plant-specific fixed cost will be lower per unit of output the larger the market is. Second,larger markets will tend to provide more local firms, more competition, conducted to lower price for the product (Shatz and Venables, 2000). Foreign direct investment in research of low cost-inputs is called “vertical” or “production cost-minimizing” FDI because it includes the vertical chain of production and move part of chain in a low cost of location.

### 2. Impact of FDI on Economic Growth

For several decades FDI and economic growth have relationship which it has been a topical issue in policy market. Policymarkers in a large number of countries are engaged in creating all kind of incentives (e.g. export processing zones and tax incentives) to attract FDI, because it is proposed to affect local economic development positively (Giroud,2007).According to the research by Lipseyi 2002,FDI affects host economies through different channels, i.e. composition effects (changing market structures), competition effects, employment effects and knowledge spillovers. Today, intra-firm trade (i.e. trade between subsidiaries and head quarters of multinational firms) may detect for one- third of total world trade and sales of multinational firms now exceeds worldwide exports of goods and services. While most FDI occurs between industrial countries, developing countries are becoming increasingly important host countries for FDI: 27% of the global stock of FDI is in developing countries. The current recovery is taking place in the wake of a drastic decline in FDI flows worldwide in 2009. After a 16 per cent decline in 2008, global FDI inflows fell a further 37 per cent to \$1,114 billion (Fig.1), while outflows fell some 43 per cent to \$1,101 billion.1 FDI flows contracted inalmost all major economies, except for a few FDI recipients such as Denmark, Germany and Luxembourg, and investment sources such as Mexico, Norway and Sweden.



Source: UNCTAD, based on annex table 1 and the FDI/TNC database (<http://www.unctad.org/fdistatistics>).

**Figure 1. FDI inflows, globally and groups of economics from 1980 to 2009**

Among Asian country, Malaysia experienced a strong growth performance in FDI(Appendix4.). The major part of investment included electronics and electrical products, chemical products, metal products ,non metallic mineral products, food manufacturing, plastic products and scientific and measuring equipments ( Ministry of Finance, 2001).

There are many research about economic growth; Yao 's research Yao 's research from 1978 to 2000 in china, shows that FDI has significantly positive effect on economic growth. Among all of the countries around the world, foreign direct investment plays serious role in China's economy. The findings of the research performed under the auspices of the OCE/MOFTE Co-operation Program on Foreign Direct Investment (FDI) among the fall 1999 and the spring 2000 explained total inward and outward FDI flows in china. In 1979 china has acquired a large part of international direct investment flows. After United States, China has become the second largest FDI recipient in the world, and the largest host country among developing countries. Chinese FDI flows can be detected according to changes in policy aims – first phase:1979-83,second phase:1984-91,and third phase:1992-99.In the first phase the China government organized four Special Economic Zones(SEZs) in two provinces, and afford special policies for FDI in these four zones. During these 5 years, the total trends of explained FDI amounted to only US\$1.8 billion, averaging US\$360 million annually. In second phase that was started from 1984,total FDI inflows added up to US\$ 10.3 in the 1984-88 periods; with an average of US\$2.1 annually (Table 3).

On the other hand, in 1989, this trend dropped steeply in 1989, mainly due to the effect of the Tiananmen adventure. The growth range of FDI inflows into China slowed down at a meagre 6.2 per cent level and in 1990 just 2.8 per cent (Table 2). Nevertheless FDI started to uphold its growth path in 1991, by recording 25.2 per cent increase visa-a-visa the previous year, the annual growth rate for second phase was declined to 11.0 per cent, that paled comparison to 38.1 per cent during 1984 to 1988. By starting the third phase in the Spring 1992, in this year china's southern coastal areas and SEZs are circuited by Deng Xiaoping. His visit had important role to push China's overall economic reform process forward and to underline China's to the open door policy and market-oriented economic reform, demonstrated to be a success in acquiring the confidence of foreign investors in China. From 1992, there was an acceleration in the inflows of FDI and reached the peaked level of US\$45463 million in 1998. In 1999, FDI flows into China dropped to US\$40398 million that was related to the Asian financial crisis and the increase of acquisition transaction in both OECD and non-OECD countries (Braunstein and Epstein,2002).

**Table 3. FDI inflows into China**

Phase (Years)	FDI inflow (US\$ million)	Annual average (US\$ million)	Annual rate of increase (%)
First Phase (1979-1983)	1 802	360	55.4
Second Phase (1984-1991)	21 546	2 693	27.2
1984-1988	10 301	2 060	38.1
1989-1991	11 245	3 748	11.0
Third Phase (1992-1999)	282 653	35 331	32.1

Note:OECD/FDI/STUDY/CHINA/Document-2-2000

Among all of the researches; some of them have ambiguous results to show impact of FDI on economic growth. In a study during 1987 to 1997 that its findings published in 2009 detected the heterogeneous effects of different sector-level FDI flows on host countries economic growth. Data was collected from 12 Asian economies(Appendix 3). The result of this study demonstrates the fascinating economic growth that was related to the impact of FDI and intense interest for policy-marketing aims. However, endogenous growth theory portends a positive relationship between inward FDI and economic growth, but this study generates ambiguous results. Because this study had two sectors(Appendix3); manufacturing sectors and non manufacturing sectors, and ambiguous result associated to these two sectors; that FDI in manufacturing sector has a significant and positive effect on economic growth in host countries(Appendix 4) but FDI inflows in nonmanufacturing sectors do not have key role in improving economic growth (Wang, 2009).

### 2.1. FDI impact on developed country

As far as, we mentioned about the vertical and horizontal effect of FDI on economic growth, we should investigate the different of multinational activity in a large sample of host countries about economic growth.

Despite the many publications on FDI and growth, experiential research obtain a blurred picture of this relationship with some studies narrating positive effects and other negative effects of FDI on Growth(Buckley et al 2007; Meyer,2004; Meyer &Sinani 2006). Broadly speaking, there some conclusion from the findings which are explained the positive relationship among FDI and growth such as Liu,Siler,Wang, ad Wei(2000) for UK and the other study on a set of developed countries between 1970 and 1999( Li and Liu,2005),and Schneider (2005) for nineteen developed countries from 1970 to1990. On the other hand, number of studies for developing countries showed a positive relationship between FDI and host country productivity, and others showing negative relations between FDI and growth have been gained as well (Borensztein,De Gregorio, and Lee, 1998). In addition, Schinder (2005) and Akinlo (2004) detect no relationship between FDI and growth for developing country. In a recent study in 2007 by Driffield and Love investigated the knowledge spillover impacts of various types FDI from 30 countries in eleven British manufacturing sectors during 1987 to 1997. They make a differentiate between vertical FDI and FDI proposed only at exploiting ownership advantage( horizontal). They discuss about the spillovers effectsof both kind of FDI will be positive. Actually both of them generate positive spillovers but those VFDI are insignificant. According to the above overview that emerges a blurred picture, but in a research by Blonigen and Wang (2005) illustrated the signification of distinguishing between developed and developing countries. So some ambiguous results may be related to the unfair comparison among FDI impact in developed and developing countries. Some of these findings consort with the results in previous studies in which it was also detected that for developed countries a positive relation between FDI and economic growth exists.

There isthe most recent study which was done by Saini,Law and Ahmad (2010) , they investigated the role of financial market developments play in mediating the effect of FDI on economic growth. The data obtained from 91 countries over the period 1975-2005. This research has a important contribution of the adoption of the regression model base on the understanding threshold impacts to get rich dynamic in the relationship between FDI, output growth, and financial markets. They identified the positive impact of FDI on growth “kick in” only after financial markets development exceeds a threshold level. This finding affirms the prominence for the government to assert on diffusion aspect in formulating FDI policies as knowledge diffusion is not maintain on welfare ground.

### **3. FDI and Domestic markets**

FDI may enhance the productivity not only of the companies earning investments, but also all companies of the host countries as a consequence of technological spillovers. This kind of spillovers impacts were made from both intra-industry (or horizontal, within the same sector) externalities and inter industries (vertical) externalities through forward linkages (Javorcik,2004). FDI may also create in expertise that the country does not have, and access to global market is easier with foreign investment.Generally, through empirical studies De Gergio (2003) distinguished that increasing cumulative investment by 1 percentage point of GDP increased economic growth from 0.1% to 0.2% in Latin America during one year, but raising FDI by the same range increase growth by approximately 0.6% a year (1950-1985),so manifesting that FDI is three times more effectual than domestic investment. There are many strong evidences about FDI which help improve economic growth through technology diffusion and develop of human capital (Borensztein,De Gregorio and Lee 1998; de Mello 1999;shan 2002a;Liu,Burr ridge and Sinclair 2002; and Kim and Seo,2003). Broadly speaking, multinational alliances have vertical inter-firm with domestic firm through formal and non-formal relation or social contacts between the employees, so multinational corporations could distribute technology and knowledge of management in local firms.

If FDI is attracted for the resource industries, such as petroleum, domestic investment in related industries will be stimulated. In addition, FDI may improve exports for the host countries and applying accepted regression model and panel data has detected a high and significantly positive association between FDI and domestic investment in China(Shan, 2002). Based on theShan’s study in 2002, the FDI has the significantly beneficial effect on Chinese economy when the ratio of FDI to industrial output increased. In financial markets field; Alfaro et al (2003) believed that FDI improve economic growth in economies with efficiently developed financial markets, while in previous study in 1996 by Salsu, and Sapsford have emphasized that unlimited trade was crucial for acquiring the growth effects of FDI. But overlay FDI has positive effect on the economic growth (Figure 1.).The domestic economy has been affected by FDI that is debated in literature, but a consensus idea has not emerged. Critics have attributed the Asian banking crisis to the growth of foreign direct investment following the liberalization of foreign investment restrictions .

The argument related to the foreign investors create a destabilizing effect on stock prices. In research that is done by Kim and Singal (2000) shows “movement of hot money” as a major concern with policy makers in developing nations. There is a highly sensitive to interest rate and future growth expectations in hot money investment issues, such that unfavourable changes in these factors result in large alteration in national trend of capital which exasperates the shock, destabilizing the economy. The authors further note that when markets are integrated, excess volatility in the foreign market brings on a similar effect in the domestic market which increase risk premium, and cost of capital and declines investment. In addition, the demand for and the value of domestic currency increased by opening market .

Dewit, Leahy and Montagna(2003) survey the effects of labour-market rigidity on the situation decision of firms in imperfectly competitive markets. While the flexibility of labour market is always an advantage in markets without strategic intercommunication among the firms, this needs not be true if firms act strategically. Kessing (2003) investigate the impact of employment protection on rivalry in markets, *ex ante* such protection may designate lower production and employment by the firms. Saint-Paul (1997 and 2002) looks at how different range of employment protection between countries make rise to distinct patterns of specialisation and different types of modifications in the countries. These studies focus on the labour market conditions as given and imply on the interaction between employment protection and other features, like as strategic behaviour in the goods markets. Another study impress the importance of labour-market situations and organisation of the labour market itself for the alternative of location for multinationals. The aim of this study was to see how various key aspects of country’s labour market impact the attractiveness of the country as a location for MNEs from different industries. And result of this study showed that In an uncertain business climate, MNEs should assess of the future in deciding to determine a branch plant. Dedication of the wages endogenously impact on both the opportunity cost of labour and redundancy payments influence the MNE’s decision. When countries compete for foreign investment, different national characteristics incline the winners in different industries (Haaland,2007).

If there are positive productivity spillovers to domestic firms and if some of this is due to raise labour efficiency, domestic firms will pay higher wages in competitive markets. Multinationals often pay higher wages, even after managing for size and other firm and sectoral characteristics (Gorg et al, 2003). This is associated to the MNEs’ ownership of firm specific assets designating that they work with higher levels of technology than domestic firms. If domestic and multinational company compete on the same labour market, domestic company have to pay higher wages to attract workers. The following table (Table 4.) summarised Aikten, Hamson and Harrison(1997) study that they estimate a probit model and make a proxy for export information externalities, and it is named the export activity by multinationals in the industry and region. Estimation of this model was according to use plant level data for Mexican manufacturing industries for 1986 and 1989. They concluded that export activities of MNEs in a sector have positive impacts on the probability of whether a firm in the same sector, either foreign or domestic, is an exporter.

**Table 4.**

	Author(s)	Country	Year	Data	Aggregation	Result
1	Aitken et al (1997)	Mexico	1986/1989	cs	micro	+
2	Kokko et al (2001)	Uruguay	1998	cs	Micro	?
3	Greenaway et al (2003)	UK	1992-1996	Panel	micro	+
4	Banga (2003)	India	1994-2000	panel	Micro/industry	+
5	Barrios et al (2003)	Spain	1990-1998	panel	micro	?

### 3. FDI Impact on International Trade

In theoretical review, FDI has considerable potential to promote growth; however the monopolistic inclination of foreign subsidiaries may displace investment (Gardiner,2000). A game theoretic model of foreign entry involving on TNC (transitional corporation) and two domestic firms that dissent in their efficiency: the domestic firms has the higher marginal cost while the TNC ‘s costs are lower.

By entering the TNC in the market, they should set up a plant or to develop one of the domestic (Heller,2004). It demonstrates that monopolization is independent of the entry barrier and is most probably to occur in countries where domestic firms are both less competitive than the TNC. Actually Heller assumed that the marginal cost of domestic enterprises is higher than that of a TNC. And the efficiency of a more efficient domestic enterprise is held unchanged.

The growth of inward FDI stock has been intensifying and transcended the growth rate of gross domestic product (GDP) in the central and Eastern European countries (CEECs) that was quite high. The impact of FDI on domestic enterprises is reckoned to be considerable in the CEECs because unique skills and resources are provided by TNCs (Bellak, 2004). Developed economic sectors are probably to make clear technological and organizational edge over smaller and less market-experienced domestic competitors. These sources of specific skills may easily be exploited to make strategic advantages. Transitional economies bring high income growth rates, that also evinces that markets are growing. This should have a significant effect on the TNCs's market-seeking FDI. There are short-term and long-term components in market serving FDI. Acquisition through FDI in CEE TEs (transition economies) as a part of short-term profit in some TNCs consider a benefit from a relative lack of competition in the local market.

In 2008, study on Africa countries (Sub-Saharan) shows that FDI crowd in direct investment (DI) and these countries will get much from measures aimed at promoting the DI climate. Actually this research posited that a key channel of the effect of FDI on development is through its impact on domestic factor markets, especially DI and employment (Ndikumana & Verik, 2008). On the other hand, analyses of the study which was done in 2009 demonstrate the impact of FDI and DI on economic growth in sub-Saharan Africa (1990-2003) and shows that DI is positive and significantly related to economic growth in the ordinary Least Squares (OLS) and fixed impact estimation, but FDI is positive only in the OLS. This study also detects that FDI has a primary negative effect on DI and subsequent positive impact in later periods for the panel of countries studied (Adam, 2009). On the contrary, with using industry-level data on the stock of German FDI, have present evidence for a positive long-run impact of FDI on the domestic capital stock (Arndt et al 2010). Prasanna's study in 2010 reveals that the increasing trend of FDI inflows into India, provide the positive impact on the DI in India, in addition, the findings of this study present the evidence that the increase in direct investment due to FDI flows is better than the amount of the FDI inflows in India. So the constitutional character of FDI in influencing investment in the host countries provided mixed results.

Changing market conditions, new products and technological are but some of the developments that conclusion in alterations in firms' production requirements. Therefore, the MNE will not view its investment as immutable and immortal and shall into account the expected costs of closure, as well as the costs of establishment and operation, in determining where to place its FDI. In research by Haaland, Wooton, and Faggio (2003), FDI was considered when the foreign production facility is not expected to survive indefinitely. This study demonstrates a trade-off between investment incentives and labour-market flexibility, in that a country which has a more flexible labour market provides it easier to attract FDI than countries has more strict rules. As the overview of the above explanation about domestic market; the impact of FDI for domestic enterprises is difficult to predict, particularly in the transition economies, because there are the numerous factors that often counteract each other to some extent. So the net impact of competitive pressure and spillovers is theoretically ambiguous and they need to be separated and analysed empirically.

Among all of the countries on the world, FDI has important role in China. Creation of the job opportunities is the most prominent impact of FDI on the Chinese economy. Generally, total employment and urban employment have increases significantly in FDI firms in China. By consideration of the sectors by the end of 1995, 8.5 million workers are employed in China's manufacturing industries. The most part of these job opportunities involved the labour incentives sectors, such as leather and fur products, clothing and other fibre products. The contribution was also significant in some of the technology sectors (electronic and telecommunication equipment). Furthermore, the research about China detect the average labour productivity of FDI firms is two and half times that of China's domestic firms and more than four times in the technology intensive industries (Coghlin & Eran 2000). Among developed countries, UK policies try to attract inward investment for stimulating domestic productivity growth. In a model of productivity growth for the indigenous sector of UK manufacturing shows that inward investment does stimulate productivity growth in the domestic sector of around 0.75 per cent per annum (Nigel 2001).



According to the literature about FDI impact on domestic market around the world, there is uncertainly view about the future local market conditions. There are so many theories which explain the reasons why FDI enhances growth performance of receiving country. According to the neo-classical growth literature, FDI is associated positively with output growth output growth because it either raise the volume of investment or its productivity and thus puts the economy on a path of higher long-term growth. There are significant economic literature on FDI and MNEs. And there are so many questions about some productions which provide and make with firms. The main question is why a firm organizes and maintains production in two or more countries. It is answered in two lines. FDI is made by MNEs can take advantage of international factor-price differences. And incorporate MNEs into general equilibrium trade model based on “headquarter services” that can be applied for supporting local plants and subsidiaries set up abroad. In contrast, management, distribution and marketing are production of headquarter services. So, MNEs plays important role to make incentive for concentrating the production of these services in a single location that are places with abundant of physical and human capital. On the other hand, there are international differences in factor benefactions and technologies provide an incendiary to locate the production of final goods in countries with lower unskilled-labourcosts.

The second link demonstrates that in order to sell goods to other countries’ market, MNEs obtain FDI to prevail transportation and trade barriers. Many studies found that FDI motivate exports. By using firm-level data for Japanese manufacturing firms, found a net complementary impact between trade and FDI, with substitution effects taking place for firms that do not export intermediate inputs. Blonigen (2001) found a substituting relationship between FDI and trade for all products but a fundamental one for cars. In 200 Clausing used country level pooled data; he showed a positive coefficient on associate sales indicating complimentarily between exports and FDI. FDI and exports are endogenous, so they are categorized as the problems in all studies that are simultaneity. According to the Markusen et al model, vertical FDI stimulate trade while horizontal one is expected to substitute for trade.

The result of the study showed that liberalisation of investment stimulates the exports when countries are not same in relative factor endowments (skilled labour and capital). Whereas investment liberalisation declines exports when countries are same in relative factor endowments. This conclusion obtains framework for finding out why previous study on the impact of FDI on trade that impelled the relationship to be the same across all countries provided conflicting result.

### **1.3. Why is FDI so common in international business? (Yeung, 2000)**

- Production or distribution facilities in a country can reduce costs of trade (transportation, tariff and nontariff barriers, transaction costs, and time) – Toyota in US
- Production within a country takes advantage of domestic sourcing of parts, components, services
- Investment and employment in host country gain political support for the international business: “quid pro quo investment” – Cemex and Southdown
- Closer to customers for manufacturers
- Take advantage of low-cost labor, highly-skilled labor, and proximity to resources
- Reduce costs of trade from import/export

In a case study of China with Zhang (2004) showed that how does FDI impact on a host country’s performance during 1987-2004 and reveal that the fundamental inflows of FDI plays important role on China export. And evidence of this study indicated that real FDI trend make determinant effect on China’s export. Consequently, domestic capital was known as a determinant factor of export and the rate of wage has negative impact on China’s export. Sharam (2003) scrutinized the effective factors of Indian ‘export during 1970-1998. Actually he examined the impressive factors on demand and supply export and detect the real effective exchange rate have a negative impact on export demand and national income have positive effect on export demand. Thus, the ratio of export productions price to domestic productions price in India has positive effect on export supply and domestic demand makes negative effect on export supply. Head and Rise (2003) evaluate the role of FDI on Japanese’s export that asset, skill and unskilled labourers have important factors in efficiency. FDI and export with together raise the efficiency of firms. The result detected the positive impact of FDI on export. Another study focuses on the chief role of invention and innovation that bring variety, competitiveness of production in developed countries (Miguel, 2005). In this study, investigator acclaimed that knowledge spillover and technology could have appositve effect on country ‘s export performance; if over flow knowledge is existed.

The relationship between trade-GDP ratio and growth in 19 MENA countries (Middle East and North Africa countries) during 1985-2005 investigated by Shamasdian et al(2010). The result of this study reveals that the majority of these countries have no significant long-term relationship between their openness and growth. Just Algeri,Kuwait, Lebanon and Syria show significant relationship between openness and growth.Science and technology concluded from research activities. Actually the stable development will be created from combination of the technology and cultural activities. Research in each country shows that investment has direct relation with export. According to the international economic theories, if countries have transaction among each other, the export of each country related to the research and development investment spillovers. Thus ,international trade raise of access to the inductor and capital productions to increase the export (Miguel,2005).Shahabadi and Sheykhahae (2010) investigate the FDI on Iran's export. Aim of this study was to survey the function and impressing the mechanism of technology spillovers from FDI and import goods on Iran's export during 1961-2009. The results of this study demonstrate that FDI has positive and significant effect on Iran 's export and non-oil export.

FDI and trade relations increase at various levels of aggregations. This finding emphasised by Mulonidis and Zarotiadis (2008) and Swenson (2004). In study with Liu et al (2001) make a panel data approach using data from China and conclude on a regular complementary association between trade flows (imports and exports) and FDI that fits well to the experiences over the last two decades of the 20<sup>th</sup> century in the some kind of country

#### **4. Conclusion**

Most of FDI scientists believe that FDI has a positive impact on the economic growth in the receiving countries. They showed that many countries like China, India and Uk use FDI as a advanced business for making economic growth. FDI can be conspicuous source for productivity growth and swifter transformation process in transition country. On the other hand, sometimes FDI theoretically cause both positive and negative spillover effects to the host country. In general,a multinational company 's decision to develop production to another is driven by lower cost and higher deficiency consideration. In the host countries, the benefit of FDI are not limited to promote use of its sources, but also branch from the introduction of new processes to domestic market, learning-by-observing, networks, training of the labour force, and other spillovers and externalities. Due to the "growth-development" benefits FDI assumes to conduct, different countries and places have followed active policies to attract FDI. Most countries, including both developed and various nations which named as emerging nations, have organized investment agencies, and have strategic that include both fascial and financial incentives to attract FDI as well as other that pursue to improve the local regulatory environment and the cost of doing business.

In many empirical evidences reveals that FDI plays a key role in contributing to economic growth. However, the level of development of local financial markets is crucial for these positive impacts to be absolved, and to the best of our apprehension this has not been shown before.

Because the developing countries elaborate beyond their traditional involvement in international production as recipients of foreign direct investment to those increasing sources of FDI, the effect of their outward FDI on the countries of origin,as well as on the host countries, significantly host developing countries consider raising significant. For the countries of origin, some questions made as ti whether the exports of capital, technology and other resources by their TNCs bring benefits to the firms undertaking them, as well as to the economy at large, and assign to the development process. For the host developing countries of FDI from the other developing courtiers, the most importance issues related to what extent such FDI adds to capital and other resources available for development, and whether the benefits and costs of such FDI differ in any situation from those of FDI from the developed countries. Investigating how FDI and related production decisions by TNCs from developing countries impact on the countries of origin is not a simple exercise, since the features of FDI vary across TNCs, industriesand countries, effecting both the method of TNCs and influencing on countries of origin. In addition, research and data on the country-of-origin impact of developing country FDI are as yet limited.

The trade and employment impacts of outward FDI on the country of origin economies associated to the motivations and type of investment abroad and this implies to developing-country FDI as well. To the extent that market-seeking motivations imply the greater part of FDI from developing countries, and such FDI has been revealed to be generally complementary to country of origin exports, a positive effect on country of origin exports may be expected.

As the largest and fastest industrialising economy in the world, China has retained a long duration of rapid economic growth. In many researches, all explanatory factors are considered to reflect real results and output is positively influenced by labour, capital, export, FDI, human capital and real foreign exchange rate. At the national level, FDI as an important part of total investment and its cross term with a time trend are detected to have a significant and positive impact on production. It is important to impress that technological progress played an important part in China's economic growth, contributing 3.5-4.3% of accumulated economic growth on an annual basis.

The overall benefit from FDI does not accrue automatically, and magnitude differs according to host country and extent. The factors that consider as the full benefits of FDI in some developing countries include the level of education and health, the technological range of host country enterprise, insufficient openness to trade, weak competition and inadequate regulatory frameworks. On the other hand, in developing countries; the level of technological, educational and infrastructure achievement are things being equal, equip it better to benefit from a foreign presence in its markets.

According to the literature FDI impact involve many aspects in international trades, but export field is important part in many studies. Impacting foreign direct investment on export depends on the type of FDI. For instance, vertical FDI is assumed to motivate trade whereas horizontal FDI is expected to substitute for trade.

Generally, existing literature have implied conflicting predictions relating to the growth effect of FDI. Scientists supporting the positive impacts of FDI on economic growth assume that it could stimulate technological change through the adoption of foreign technology and know-how and technological spillovers, so modernizing host country economy. The opponents views hold that FDI may bring about crowding out impact on domestic investment, external vulnerability and dependence, destructive competition of foreign connections to domestic firms and "market –stealing effect" known as a result of poor absorptive capacity. Many countries have regarded FDI increasingly as contributing to their development strategies for the technology and capital it applies, and therefore have made to compete for FDI. Policies about investment have become liberal at the national and regional level, but scientists still do not find the comprehensive framework for FDI at multinational level. Home countries are hoping to push FDI into developing countries using guarantee funds and matchmarketing.

All in all, in recent years, there are significant shifts towards liberalisation of the FDI regime, and FDI is considered more favourably now than a couple of decades ago. And now many governments find out about the policies can influence the impact of FDI on development. The kind of sequencing of general and special policies in areas covering investment, trade, innovation and human resources are all important.

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