THE IMPACTS OF FOREIGN DIRECT INVESTMENT ON THE ECONOMY

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Abstract: This paper analyses general theories related to foreign direct investment and outlines findings by European researchers on the economic growth of the V4 countries from 1999 to 2015.

Key words: responsibility, lower classifications, source country.

Introduction.

In the world, countries are classified into three economic groups: developed, developing, and underdeveloped. These classifications are based on economic indicators such as GDP, GDP per capita, unemployment rate, and currency power. Between them, developed countries account for a high proportion of the world economy, and as a result, they take responsibility for supporting other countries with lower classifications. Those big players either lend funds or, preferably, invest in low-income economies. In theory, those kinds of investments are called foreign direct investments (FDI).

What is foreign direct investment?

So-called FDI is the mechanism by which people from the source country (investors) use the land, labour, and resources of the host country (investor recipients) to establish businesses and control them over time (Moosa 2002). In other words, investors from developed countries use the land, labour, and resources of another underdeveloped or developing country to expand their business, cut labour costs, or increase production, etc. For example, some investors work in the retail sector, targeting clothing. The clothing manufacturing industry requires large quantities of wool and other related raw materials, as well as a high-capacity workforce. We can assume that the materials to be used need to be transported from another country, and as the country develops, wages will be high, increasing production costs. This situation will lead to lower consumer demand, so there will be no profit maximisation. The investors will not make their intended money out. So, what if they buy some land in the lower economy (host country now), establish a manufacturing site, use their human capital at lower rates, and buy materials directly, without the need for long-distance transport?! It will result in higher production at low cost, peak-level profit, and transportation only of the ready goods. It will benefit both sides, as the host country will have a small impact on money circulation, lower unemployment, and greater trade-offs internationally.

The impact and importance on the economy.

The studies by Fifeková and Nemcová (2015) on the impact of FDI inflows on V4 countries provide evidence of the mechanism. The researchers examined the economic growth rates of those four countries (Hungary, Poland, Slovakia, and the Czech Republic) using time periods of 1995-2015, 2004-2008, and 2009-2014.

Table 1. Fifeková and Nemcová (2015).

According to the table, the average GDP growth rate for the V4 countries over the 16 years was 3.09%, while the 4-year period (2004-2008) resulted in a 5.09% average increase. These statistics show the impact of FDI inflows, as they mainly occurred during the high-growth period. As mentioned above, FDI contributes to labour and capital markets, overall strengthening the economy. As we can see, the last period had very slow growth, coinciding with FDI cuts by source countries. These couple of figures are big enough to outline the real impact.

Conclusion.

Foreign direct investments are the best tools to be directed by developed countries into developing countries to assess the trade-offs, keep the world away from financial crises. Their impact is great on many factors like unemployment, or any industrial sector. They will lead to industrial innovations, improvements on global infrastructure, equality of the nations and contribute to the world peace.

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