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The role of foreign direct investment (FDI) in sustainable development

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ABSTRACT

For many people, globalization is a key to reaching a high level of development and welfare for all the countries of the world. Yes, there are great opportunities connected with globalization, but there are also quite significant risks. Globalization supports the ability of investors and traders to locate their capital and to exchange goods and services wherever they choose. But there is a risk of environmental standards being lowered. To avoid this, we have to strengthen our efforts to ensure a coherent global and ecologically responsive framework of environmental agreements and institutions, in order to guarantee that globalization will support sustainable development. The Governments are very active in creating attractive framework conditions for business activities. Reducing tariffs and signing trade and investment facilitating agreements are good examples. In turn, we also see companies taking on greater responsibility towards supporting sustainable development in their foreign direct investment (FDI). This paper seeks to review some of the pros and cons of FDI, to broadly consider possible roles and responsibilities of institutions in order to utilize FDI in a more effective manner and suggest some key questions that will need to be faced.

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The role of foreign direct investment (FDI) in promoting growth and sustainable development has never been substantiated. There isn't even an agreed definition of the beast. In most developing countries, other capital flows - such as remittances - are larger and more predictable than FDI and ODA (Official Development Assistance).

Several studies (Bramble, 2000; Konings, 2001; Fazekas, 2003) indicate that domestic investment projects have more beneficial trickle-down effects on local economies. Be that as it may, close to two-thirds of FDI is among rich countries and in the form of mergers and acquisitions (M&A). All said and done, FDI constitutes a mere 2% of global GDP. FDI does not automatically translate to net foreign exchange inflows. To start with, many multinational and transnational "investors" borrow money locally at favourable interest rates and thus finance their projects. This constitutes unfair competition with local firms and crowds the domestic private sector out of the credit markets, displacing its investments in the process.

The UN Commission report "Financial Resources and Mechanisms" on Sustainable Development indicates increased international dialogue about whether FDI is a significant source of development finance. For all its potential, there is far greater awareness of the complex nature of FDI and the possible negative impacts of rapid and large growth for least developed countries. A crucial question is how FDI might be better applied to support more sustainable forms of development, particularly in those countries with burgeoning debts and widening income disparity to the rest of the world (Jun and Brewer, 1997).

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The pros and cons of FDI as a source of development:

Attraction of FDI is becoming increasingly important for developing countries. However, this is often based on the implicit assumption that greater inflows of FDI will bring certain benefits to the country's economy. FDI, like ODA or any other flow of capital, is simply that, a source of capital. However, the impact of FDI is dependant on what form it takes.

This includes the type of FDI, sector, scale, duration and location of business and secondary effects. A refocusing of perspective, from merely enhancing the availability of FDI, to the better application of FDI for sustainable objectives is crucial to push the debate forward. Various international foray and discussion have