# CONTRIBUTION AND PROBLEMS OF FOREIGN INVESTMENT TO SUSTAINABLE DEVELOPMENT OF DEVELOPING COUNTRIES

**Ass. Professor Olivera Gjorgieva-Trajkovska[1]**
**Ass. Professor Janka Dimitrova[2]**
**Ass. Professor Vesna Georgieva-Svrtinov[3]**

## Abstract

Foreign direct investment impacts on investments in the domestic economy are significantly higher comparing to those of other capital flows. Besides evident direct FDI (foreign direct investment) effects on investments, there are so-called indirect effects that can be positive (crowding in) or negative (crowding out). Besides the transfer of new technologies, expertise and good practices with FDI inflows, the positive crowding in effects of FDI appear when FDI generate new investments by other domestic companies, where the relationship input - finished goods or inversely could be set up.

Today the process of economic liberalization, improved transport and communication systems and increased global demand for commodities like energy, mineral resources and agricultural products, have fostered investments in related projects, especially in developing countries. This create opportunity, but also risks for sustainable development of these countries. That's why governments must carefully evaluate the terms and consequences of investment projects and also the extent to which they advance-or undermine sustainable development goals, like poverty reduction or environmental protection.

**Key words**: foreign investments, sustainable, development, developing countries, contribution, improvements

## Introduction

There are many dimensions to sustainability. First, it requires the elimination of poverty and deprivation. Second, it requires the conservation and enhancement of the resource base which alone can ensure that the elimination of the poverty is permanent. Third, it requires a broadening of the concept of development, so that it covers not only economic growth, but also

[1] Faculty of Economics, University "Goce Delcev" Stip; olivera.trajkovska@ugd.edu.mk
[2] Faculty of Economics, University "Goce Delcev" Stip; janka.dimitrova@ugd.edu.mk
[3] Faculty of Economics, University "Goce Delcev" Stip; vesna.svrtinov@ugd.edu.mk

social and cultural development. Fourth, and most important, it requires the unification of economics and ecology in decision making at all levels.

The principle of sustainable development is at the very heart of international environmental law. This principle not only recognizes the right to economic development of the developing countries but also emphasizes the importance of environmental protection. Critics of economic globalization have identified that the competition between countries for investment may result in a neglect of environmental concerns; that national governments are gradually losing their influence over important domestic issues; and that globalization undermines the traditional balance of power between rich and poor.[4]

*"Gllobalization must mean more than creating bigger markets. To survive and thrive, a global economy must have a more solid foundation in shared values and institutional practices".*

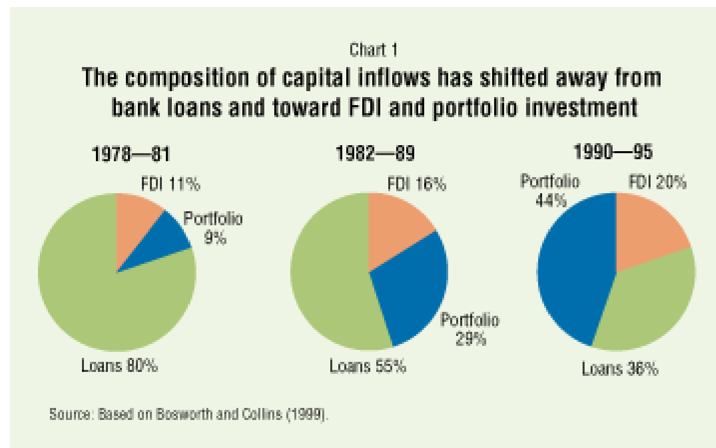
In the second half of the twentieth century, apart from the international law on the use of armed force, no area of international law has generated as much controversy as the law relating to foreign investment. Yet it has emerged as the most important phenomenon in today's economic relations. In general terms foreign investment means the transfer of tangible or intangible assets from one country into another, for the purpose of use in that country to generate wealth, under the total or partial control of the owner of the assets.

## The role and problems of foreign direct investment

Foreign direct investment (FDI) has proved to be resilient during financial crises. For instance, in East Asian countries, such investment was remarkably stable during the global financial crises of 1997-98. In sharp contrast, other forms of private capital flows—portfolio equity and debt flows, and particularly short-term flows—were subject to large reversals during the same period

This resilience could lead many developing countries to favor FDI over other forms of capital flows, furthering a trend that has been in evidence for many years (Chart 1).

[4] Jan McDonald, *The Multilateral Agreement on Investment; Heyday or MAl-Day for Ecologically Sustainable Development,* Melbourne UNN. L.R. 617, 620 (1998).




Economists tend to favor the free flow of capital across national borders, because it allows capital to seek out the highest rate of return. Unrestricted capital flows may also offer several other advantages, as noted by Feldstein (2000). First, international flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions. Third, the global mobility of capital limits the ability of governments to pursue bad policies.

In addition to these advantages, which in principle apply to all kinds of private capital inflows, Feldstein (2000) and Razin and Sadka note that the gains to host countries from FDI can take several other forms:

- FDI allows the transfer of technology—particularly in the form of new varieties of capital inputs—that cannot be achieved through financial investments or trade in goods and services. FDI can also promote competition in the domestic input market.
- Recipients of FDI often gain employee training in the course of operating the new businesses, which contributes to human capital development in the host country.
- Profits generated by FDI contribute to corporate tax revenues in the host country.

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 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.[5]

Many transnational corporations are net consumers of savings, draining the local pool and leaving other entrepreneurs high and dry. Foreign banks tend to collude in this reallocation of financial, where withal by exclusively catering to the needs of the less risky segments of the business scene. Additionally, the more profitable the project, the smaller the net inflow of foreign funds. In some developing countries, profits repatriated by multinationals exceed total FDI. This untoward outcome is exacerbated by principal and interest repayments, where investments are financed with debt and by the outflow of royalties, dividends and fees. This is not to mention the sucking sound produced by quasi-legal and outright illegal practices such as transfer pricing and other mutations of creative accounting.

In general, developed countries have dictated the rules or terms for receiving incoming investment through regional and bilateral agreements and conditions imposed by international financial institutions. Usually justified by a need to protect foreign investors against outright seizure or abusive regulation, international investment rules grant broad rights and enforcement powers to investors, but in the process they restrict the ability of national and local governments to regulate the activities of foreign investors to meet local developmental, environmental or social priorities. In practice, the "high standard" model of international investment rules has proved to favor the narrow commercial interests of corporate investors over broader societal interests, which is compounded by the failure of existing investment agreements to require even minimum corporate responsibility standards.

Many think that the most troublesome aspect of this flawed approach to managing international investment flows is the inclusion of a direct investor-to-state dispute mechanism in some bilateral investment treaties. This brief describes the key provisions of the "high standard" model of investment liberalization promoted by certain developed countries and illustrates the danger it presents to sustainable development policies, through the use of several case studies.

## Some facts about the FDI in Macedonia

FDI inflows are considered as ones of the main driving forces of the transition economies. The average FDI net inflows in the Macedonian economy in the period 1999 – 2010 were about 4% of GDP, which is relatively lower compared to some other transition

---

[5] Sam Vaknin, Ph.D.”Why the Constant Failure to Attract FDI to Macedonia?”,Conference, Skopje, 2011

economies (the Czech Republic, Slovakia, Bulgaria, the Baltic countries). This could be explained by various reasons. Potential foreign investors are sensitive to numerous factors when making decision about investing abroad, starting from the market size, economic developments and general prospects for growth of the economy, and going further to business climate, overall infrastructure, regulatory and administrative issues. It must be noted that FDI inflows were quite stronger in the period 2006-2008, that coincide with a stronger GDP growth in these years.[6]

The analysis of the FDI stocks by sectors has shown that FDI inflows in the non-tradable sector were higher compared to those in the tradable sector, therefore contributing to a higher and faster growing GDP in the non-tradable sector. Within the non-tradable sector, the largest portion of FDI inflows was in the telecommunication sector.

## Conclusion

Low-income or industrializing (developing) countries, such Republic of Macedonia, can benefit greatly from foreign investments inflow. Macedonia is constantly at the bottom of the state recipients of foreign direct investments in Europe. The researches shows that besides government inability, corruption, geographic and political risks and lack of modern infrastructure, the main principals for current situation are: overall wrong way of functioning of institutions, lack of commitment to true reforms, underdeveloped private sector, specific mentality, low level of research, development and innovations, inconsistent education system, different banking system and undeveloped capital market. All these points are actually main areas which deserve attention and hard work, toward their improvement and bringing them in state favorable for attracting foreign investments, necessary for sustainable development of the country.

## References

[6] Aneta Krstevska and Magdalena Petrovska"The economic impacts of the foreign direct investments: panel estimation by sectors on the case of Macedonian economy", Journal of Central Banking Theory and Practice, 2012

1. Jan McDonald, *The Multilateral Agreement on Investment; Heyday or MAl-Day for Ecologically Sustainable Development, 1998*
2. Benacek, V., Gronicki, M., Holland, D., Sass, M. (2000). The Determinants and Impact of Foreign Direct Investment in Central and Eastern Europe: A comparison of survey and econometric evidence, Transnational Corporations, Journal of United Nations, vol.9, no. 3, New York
3. Dunning, John H. and John Dilyard (1999). "Towards a General Paradigm of Foreign Direct and Foreign Portfolio Investment," *Transnational Corporations*, No. 8, April, forthcoming.
4. Eichengreen, Barry and Michael Mussa (1998). "Capital Account Liberalisation and the IMF," *Finance and Development*, No. 35, December.