Foreign Direct Investments and The Fate of the South in The 21st Century North-South Divide.

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Abstract

Foreign Direct Investment is a relatively new phenomenon in the entire globe that has impacted immensely on international economic growth. It has received notable attention in the 21st century in the form of ownership of financial assets. The main thrust of this paper is to assess the fate of the South with specific reference to FDI operations under the umbrella of the North-South Divide. The paper adopts the secondary source of data which comprises review of relevant literature to integrate the concept of FDI, the North- South Divide and their impact. It discovers that FDI may lead to the loss of Sovereignty in some national economies of developing countries. It recommends a balanced approach in the utilization of FDI in developing countries of the south.

Introduction

This work adopts the descriptive qualitative historical method to determine the fate of the South in the Foreign Direct Investment activities channeled to the South in the 21st century North-South Divide discourse. Foreign Direct Investment according to IMF, "is an investment involving a long-term relationship and reflecting a lasting interest in an entity that operates and stays in one place (the investor) in an economic entity that diverts to another place that is different from where the investor is resident." Foreign Direct Investment could also be said to mean the practice of international businesses investing in countries other than their home country.

In recent months, there has been much debate over whether opening of economies to foreign direct investment is good for developing countries of the South.

Many have argued that foreign direct investment amounts to surrendering the sovereignty of the country though some other scholars view it as a blessing for the economy.

Whatever be the stance, it cannot be denied that with the global economy being integrated so tightly, developing countries have no choice but to allow foreign direct investment. However, they can have some restrictions on which sector to invest and how much profit can be repatriated.

Meanwhile people move from one place to another with the purpose of exchanging goods of a country with those of another one to attain what was missing in the country where they lived. These first exchanges were through barter to product and latter money was introduced in circulation to be exchanged with the product. These first forms of trading were increasingly altered even more today where capital moves from one country to another. Foreign Direct Investments, FDI is a relatively new phenomenon in the entire globe. This phenomenon that has affected global economic growth and improved living standards, received notable development in the 21st century in the form of loans that some advanced economies like English used to finance economic development in different countries as well as in the form of ownership of financial assets.

The end of World War II marked the flourishing of the phenomenon of FDI for two main reasons. Firstly, the development of technology favored transport and communications which enabled the possibility of control in distance as a condition for the development of FDI. Secondly, Europe and Japan needed the capital of United States of America for reconstruction. In this period U.S.A. adopted a tax system that favored foreign investments.

Recent developments of the early 21st century is proving that in this globalized world of opportunities for trade exchanges, the provision of quality services without frontiers of languages or distances have no limits and are extraordinary. What motivates today economic operators to conduct foreign direct investments is the desire to take control of certain production activities abroad, naturally without forgetting another very important factor which is economic benefits. This phenomenon has attracted the attention of many social factors, political and mainly economical.

There is also a widespread belief among international institutions, academicians, policymakers, and researchers that foreign direct investment (FDI) has a huge positive impact on the economic growth of the developing countries. By now it is well recognized that FDI can significantly benefit the economy of the host country, and this may be the reason that governments of many countries around the globe formulate strategies that attract foreign direct investment in their countries. In addition to the direct capital financing, FDI can benefit the host country through technology spill overs, human capital formation, creation of competitive business environment, enterprise development and integration of international trade. Therefore, many emerging economies have liberalized their FDI regime and formulated FDI favorable policies.

Many international institutions, politicians and economists consider Foreign Direct Investment as a major tool of the economic growth of a country as well as the solution of economic issues. Foreign Direct investment plays a major role in the economic expansion when there is a shortage of domestic savings. Foreign Direct Investment (FDI) has been emerged as a catalyst for accelerating the economic growth of developing countries. It is not only an important source of capital inflows but also a major source of technology transfers in the host country. The capital inflows and technology transfer are considered as accelerators for economic growth, so foreign direct investment (FDI) is more likely to promote the economic growth of the host country. Foreign direct Investment promotes the economic growth of a host country through various channels, but the most important channels are technology transfer and spill overs. Technology transfer can be taken place in the host country through multinational firms while spill overs could be occurred by the interaction of domestic firms through the interaction of multinational firms with domestic firms, suppliers, customers, and work force. Therefore, FDI can have a positive impact on income.

Even though many studies established the idea that FDI has a positive impact on the economic growth of a host country, there are some studies that argue that the relationship between FDI and economic growth is ambiguous. For instance, Aitken and Harrison states that the net impact of foreign direct impact on the host country is very small. Borensztein et al is of the view that FDI can only contribute to the economic growth if the host country has sufficient absorptive capacity of advanced technology. Although, there is no consensus on the effects on FDI on the economic growth of the host country but the number of studies that show the positive effects of FDI is much higher than those which focus on the negative effects.

''The characteristics of FDI, its rapid growth and pivotal role in the process of globalization in recent years, its intimate relationship with trade, and its historical antecedents have all attracted the attention of economists, political scientists, economic historians and in recent years management specialists and anthropologists'' according to V.N Balasubramanyan 2002. The principal characteristic of FDI, which sets it apart from other sorts of international capital flows, is the control over operations exercised by the investing entity over the investor entity. Ownership of equity and more importantly command over technology and know-how enable firms to exercise control over operations. It is control over operations that enables foreign firms to transfer technology and know- how to the recipients of FDI. And FDI is a potent instrument of development because of its ability to transfer technology and skills to developing countries.

Voices of dissent and opposition to FDI continue to be heard, principally from the critics of Globalization (Noorena Hertz, 2001), the challenges facing policy makers in developing countries are now of a different order than those during the decades of the sixties and the seventies. Briefly put, it is how best to attract substantial volumes of FDI and utilize it effectively in the promotion of development objectives. Effective utilization of FDI involves not only maximization of the benefits of FDI but also minimization of its costs, for FDI is not without its social costs. One of the enduring worries of host countries with FDI is the exercise of control over decision making by foreign firms. For acquisitions involve the takeover of existing locally owned firms by foreign firms and the surrender of control over operations by the former to the latter.

The North

The Global North mostly correlates with the Western world—with the notable exceptions of Japan, South Korea, Singapore, Taiwan, and Israel— and the South largely corresponds with the developing countries previously called "Third World," plus the Eastern world. Geographically, the Global South is mostly composed of regions that are neither Western nor Eastern such as the West and most African countries. The two groups are often defined in terms of their differing levels of wealth, economic development, income inequality, democracy, and political and economic freedom, as defined by freedom indices. States that are generally seen as part of the Global North tend to be wealthier and less unequal with large, well-developed infrastructure as well as advanced technology, manufacturing, and energy industries. Southern states are generally developing countries with younger institutions. They tend to be heavily dependent on primary sector exports. The divide between the North and the South is often challenged.

The terms are not strictly geographical and are not "an image of the world divided by the equator, separating richer countries from their poorer counterparts." Rather, geography should be more readily understood as economic and migratory, the world understood through the "wider context of globalization or global capitalism."

Generally, definitions of the Global North is not exclusively a geographical term, and it includes countries and areas such as Australia, Canada, the entirety of Europe and Russia, Israel, Japan, New Zealand, Singapore, South Korea, Taiwan and the United States. The term Global North is often used interchangeably with developed countries.

The South

The Global South is a term often used to identify regions within Latin America, Asia, Africa, and Oceania. It is one of a family of terms, including "Third World" and "Periphery", that denote regions outside Europe and North America, most (though not all) of these countries are low-income and often politically or culturally marginalized on one side of the divide, the other side being the countries of the Global North (often equated with developed countries). As such, the term does not inherently refer to a geographical south; for example, most of the Global South is geographically within the Northern Hemisphere.

The term as used by governmental and developmental organizations was first introduced as a more open and value-free alternative to "Third World" and similarly potentially "valuing" terms like developing countries. Countries of the Global South have been described as newly industrialized or in the process of industrializing, and are frequently current or former subjects of colonialism.

The Global South is made up of Africa, Latin America and the Caribbean, Pacific Islands, and the developing countries in Asia, including the Middle East. It is generally seen as home to Brazil, India, Indonesia and China, which, along with Nigeria and Mexico, are the largest Southern states in terms of land area and population. The overwhelming majority of the Global South countries are located in or near the tropics. Likewise, the term Global South is often used interchangeably with developing countries.

Three and a half billion people, three quarters of all humanity, live in the developing countries. By the year 2000, the proportion will probably have risen to four fifths. Together the developing countries-accounting for more than two thirds of the earth's land surface area-a re often called the Third World.

We refer to them as the South. Largely bypassed by the bene- fits of prosperity and progress, they exist on the periphery of the developed countries of the North. While most of the people of the North are affluent, most of the people of the South are poor; while the economies of the North are generally strong and resilient, those of the South are mostly weak and defenseless; while the countries in the North are, by and large, in control of their destinies, those of the South are very vulnerable to external factors and lacking in functional sovereignty.

The countries of the South vary greatly in size, in natural re- source endowment, in the structure of their economies, in the level of economic, social, and technological development. They also differ in their cultures, in their political systems, and in the ideologies they profess. Their economic and technological diversity has become more marked in recent years, making the South of today even less homogeneous than the South of yesterday.

Yet in this diversity there is a basic unity. What the countries of the South have in common transcends their differences; it gives them a shared identity and a reason to work together for common objectives. And their economic diversity offers opportunities for co-operation that can benefit them all.

The primary bond that links the countries and peoples of the South is their desire to escape from poverty and underdevelopment and secure a better life for their citizens. This shared aspiration is a foundation for their solidarity, expressed through such organizations as the Group of 77 of which all countries of the South except China are members and the Non-Aligned Movement, with a large and growing membership from all continents in the South.

The decision-making processes that govern the international flows of trade, capital, and technology are controlled by the major developed countries of the North and by the international institutions they dominate. The countries of the South are unfavorably placed in the world economic system; they are individually powerless to influence these processes and institutions and, hence, the global economic environment which vitally affects their development. For this reason, they have made a collective demand for the reform of the international economic system to make it more equitable and responsive to the needs of the vast majority of humanity-the people of the South. The struggle for a fairer international system has consolidated their cohesion and strengthened their resolve to pursue united action.

The Challenges to The South

The South covers the larger part of the Earth's surface. Its people are most of the world 's inhabitants. But they have a very much smaller proportion of the world 's income than the people of the North. Hundreds of millions of the people living in the South suffer from hunger, malnutrition, and preventable d is- eases, illiteracies which implies or lack education and modern skills. The peoples of the South have begun to say that these conditions are unacceptable. They must now make that rejection effective.

The challenge to the South is to reaffirm, in words and action, that the purpose of development is the promotion of the well-being of its people, with economic growth directed at satisfying their needs and fulfilling their purposes.

The challenge to the South is to strengthen democratic institutions so that its people may live in freedom and chart their own path to development in harmony with their culture and values.

The challenge to the South is to use its own resources more effectively to accelerate its development, giving priority to meeting the basic needs of its people and freeing them from poverty, disease, ignorance, and fear. The challenge to the South is to enable its people to realize the full potential of their talents and creativity, and to develop self-confidence, and to mobilize their contribution to the well-being and progress of their societies.

The challenge to the South is to enlarge its capacity to benefit from advances in science and technology in securing a better life for its people.

The challenge to the South is to pursue its development with due concern for the protection of the natural environment so that it may sustain the present and future generations.

The challenge to the South is to organize itself effectively and to seek strength through wide ranging joint undertakings of South-South co-operation which benefit from complementary re- sources and increase collective self-reliance.

The challenge to the South is to use its unity and solidarity in efforts to make the world a more just and more secure home for all its people, through a restructuring of global relationships that responds to the growing intimations of the interdependence of the world's nations and people: members of one human family living in one world.

The Detrminants of FDI

Market Size

The purpose of this section is to provide variables, identified, here, as potential factors in influencing foreign direct investment decision. The most intrinsic characteristics to define FDI is to analyze its determinants, such as the **market size; market growth**; At this point we find it necessary to mention that the well-documented relationship between FDI and growth is an interactive process. Not only FDI promotes output levels in the host economy but also the level of economic development, as a determinant, plays a significant role in attracting FDI. Theoretical and empirical evidence consider two mechanisms playing an important role in attracting FDI: (a) the market size and (b) the level of economic development.

Morrissey and Rai (1995), claims that the **size of the domestic market**, as well as growth prospects of recipient economy are highly taken into consideration when foreign investors relocate production in the host country. The later argue that international agreements on trade and investment also affect the volume and direction of FDI flows. Agarwal (1980) points out that FDI is a function of output or sales of foreign firms in the host country. This is usually approximated by the size of market –either the absolute, captured by the level of GDP (Bandera and White, 1968), or the relative, expressed by the growth rate of GDP of the host country.

Economic Development

Foreign Direct Investment inflows concerns the stage of economic development and the so-called Investment Development Path (IDP) of the recipient country (Barrell & Pain, 1998). A well-developed existing market infrastructure is expected to support FDI decisions (De Menil, 1999). Major studies encounter and measure IDP rates using GDP per capita proxies. For instance, Agarwal (1990) and Mainardi (1992) emphasized the level importance and growth prospectus of the real per capita GNP per se and the role of real GDP growth in taking investment decisions in a region. Head & Ries (1996), Cheng & Kwan (1999), use infrastructure factors, proxied by road constructions (km/km2 of land mass), and additionally the regional income as potential variables for FDI attraction. Another important supply condition, that is promoting labor-intensive and export oriented FDI, is the human capital both in terms of quality and availability. In this the capital stock created by investing over and above the depreciated capital, expands the productivity potentials of a firm or a country and enables FDI growth enhancing effects (De Mello, 1997). This, however, presupposes a minimum human-capital efficiency level and assumes that further training is attainable. However, empirical literature concerning the impact of educational level on inbound FDI appears to be counter intuitive.

Guntlach, (1995) argues that the poor explanatory power of human capital accumulation is attributed to the fact that education creates externalities and spillover effects in production, which are hard to capture using standard set of variables. More explanatory power can be achieved by identifying the role of human capital augmentation, rather than human capital accumulation, which may be poor explanatory variable in growth models because the crucial role of educational variables is difficult to be captured in using standard growth accounting. Recent literature puts forward agglomeration effects as a significant factor of attracting FDI. Venables, (1996) argues that agglomeration economies arise from the presence of other firms, other industries, as well as from the availability of skilled labour force. Empirical evidence evaluating agglomeration effects is limited though, partly because of data limitations and difficulties in obtaining definite statistical specifications. Wheeler & Mody (1992) found that the US FDI is attracted by the size of the total inward investment. Head et al (1995) using plant-level data argue that the locational FDI attraction in a sector is mostly determined by the location of existing firms in that industry. Barrell and Pain (1999a) point out that the FDI in Europe is attracted by agglomerations proxied by market size and a 5-year moving average of stock manufacturing patterns, among other determinants.

Government Policies

Governmental Policies could also be important determinants of FDI flows since governments consider FDI flows as means to fight unemployment and to enhance national growth rates. Governmental policies can take a variety of forms such as tariffs, taxes, subsidies, regulatory regime, and privatization policy. For instance, a relative increase in tariffs or taxes rates in the host country is expected to raise the cost of investment, resulting in eliminated profitability rates. Cheng & Kwan (2000) having examined empirical evidence on governmental capabilities and recourses found that governments are major catalysts for economic restructuring and location attraction of inward FDI. Indeed, when the Chinese government launched an open-door policy, China has emerged as the second largest recipient in the world (after US) since 1993. Morrisey and Rai (1995) point out the institutional features of the recipient economy and the degree of political intervention as a catalyst for economic restructuring and hence as a potential determinant of FDI.

Liberal Degree of Trade Regime

Another possible determinant in attracting FDI inflows is the liberal degree of trade regime. Although there exist obvious difficulties in measuring the above factor, a general positive relationship between a liberal trade regime and FDI, is anticipated. In EU, UK's success in attracting FDI inflows, was founded in three key factors: a) the liberalization of foreign owner regulation, b) the privatization program in traditionally state activities

(telecommunication, railways, electricity, water), c) the financial deregulation, the "Big Bang" in 1986, (Raines et al., 1999). Bhagwati, (1978) argues that FDI is captivated by countries that implement export promotion than those promoting import substitution policy. Milner and Pentecost (1996) proxy the trade regime as the ratio of exports to sales and sales concentration ratio and report that both variables are found to contribute positively to FDI. Wang & Swain (1995) examine the case of export oriented FDI and find positive influence on inbound FDI. Recently, the inherent disadvantage of closed economies is outweighed by the launch of special Export Processing Zones. Cheng & Kwan (2000), for example, found that the Chinese Economic Zones exert a positive and significant influence on attracting FDI. New political factors have been clearly emerged due to global economic trends such as economic integration among connected nations and trade liberalization all around the world. Recent studies report evidence that the Single Market Program (SMP) among the EU countries promoted the level of investment rates within member states. De Menil (1998) Arrowsmith et al. (1997) and Pain (1997) states that the EU involves increases in the flow of information and capital, which in turn increase FDI flows. Pain & Lansbury (1997) report ambiguous results concerning the labor market reforms in UK, which although having reduced the total labor costs, they failed on promoting the anticipated FDI attraction. More specifically UK performed poorly in attracting FDI from those sectors where innovations were growing most rapidly. Cheng & Kwan (2000) report that wage costs have negative effects on FDI, contrary to Chen (1996), who found that labor compensations do not have any influence on FDI and to Head and Ries (1996), who outcome a completely neutral impact of wages.

The Benefits of FDI to The South in The 21st Century-
Foreign Investment is More Stable Than Fund Inflows

In recent years, "hot money" or speculative capital has flown into many developing countries leading to their stock markets becoming overvalued. Foreign direct investment on the other hand is more stable because the foreign businesses setup physical infrastructure as well as because many developing countries do not have full convertibility of their currency on the capital account. In contrast, we are often treated to the spectacle of stock markets crashing because foreign funds have left the country in a hurry and have dumped the stocks.

Technology Transfer

Though this aspect was debated hotly in the 1990s when foreign businesses started to expand, technology transfer does take place. The point to be noted here is that technology transfer takes place more in joint ventures rather than subsidiaries as the local partners get the exposure in the former. This is one reason why many patents intensive multinationals

set up subsidiaries instead of joint ventures. Of course, it is also the case that the developing countries have wizened and are insisting on technology transfer as a prerequisite to allow foreign businesses into their countries. Moreover, when developing countries import capital goods on a bulk scale, they also insist that the capacity to manufacture them be part of the agreement.

Exposure to Global Best Practices

A major benefit to the developing country is the exposure to global best practices that accompanies foreign investment. Because most of the multinationals that setup shop in developing countries are world-class companies, they bring with them global best practices in their chosen sectors, which can benefit the target countries and the workforce in them. For instance, because of the presence of so many multinationals in the software sector in India, the homegrown companies have adopted some of the HR practices of these multinationals leading to beneficial effects.

Employment Generation

While many debate the aspect of creating jobs by foreign businesses in the developing countries, one has to accept that foreign investment does create jobs both directly and indirectly. For instance, the direct employment generated by the foreign businesses supports the ecosystem around the factories and the plants wherein those employed by the foreign business live. This is because these employees need to eat, commute, and live apart from their working hours, which means that they need sustenance from local businesses that cater to them and their families. Moreover, suppliers, vendors, and local communities benefit because of the ecosystem support that factories of the foreign businesses engender in their locations.

Methodology and Data

Secondary data sources were used to assess the impact of FDI, that is obtaining data through the field work, library and archival research as to obtain intelligence reports that addressed most the effect or fate of the South in the 21ST Century FDI activities in the North – South Divide. The writer employed the use of descriptive approach of data analysis to assess the relationship with other variables associated Foreign Direct Investment.

Recommendations FDI to Developing Countries

The South in the 21st century still do not have the necessary resources at their disposal to develop some sectors of their economy and hence, they permit foreign capital to invest in these sectors. Of course, they also should ensure that sectors like defense and other sectors that have national security implications are kept off the list of sectors in which foreign

direct investment is allowed. For many countries, opening of their economies results in benefits since they need the dollars as well as because they might not have the expertise to commence productive activities in these sectors. Finally, foreign direct investment can be used to pay for expensive imports of her country which usually is made in dollar and encourage exports as well.

Conclusion

There are many complication in allowing Foreign Direct Investment into the developing countries. However, the developing countries benefit because of inflow of dollars and much needed capital, which is not available domestically, there is scope for outflow of dollars as well since the foreign companies typically repatriate a part or whole of their profits back to their home countries. This is the reason why developing countries must think twice before allowing blanket foreign direct investment. To circumvent this, many developing countries of the South divide in the 21st century should typically restrict foreign direct investment into sectors that badly need capital and where the developing country do not have expertise. Further, the fact that many developing countries have capital controls on the capital account (which is to restrict wholesale repatriation of both profits and investment) and relax the current count where only profits and that too a percentage of it is repatriated.

The key point here is that no country can be isolated from the global economy currently. Hence, it is in the interest of developing countries to allow foreign direct investment though some safeguards can be put in place as discussed above. Of course, the best path would be to not have a blanket ban on foreign investment nor to allow 100% foreign investment.

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