

THE SOCIAL IMPACT OF FOREIGN DIRECT INVESTMENTS IN THE HOST COUNTRIES: CHALLENGES AND OPPORTUNITIES

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Abstract. *The last years have experienced an increase in foreign direct investments, especially in developing countries, where the market is still at the beginning and the investment can grow faster than in developed countries. This is happening due to the liberalization of some economic policies in order to attract foreign direct investments inflows. Attracting foreign investors is not only influential for the economy; it has also a lot of consequences and effects on the social welfare of citizens in developing host countries. The purpose of this paper is to show if there is a social impact of foreign direct investments inflows to developing countries and to determine whether or not this investments contribute to the well-being of society. This paper also analyzes if the impact has a positive or negative effect and which are the current trends in the relation between investments flows and society.*

Keywords: *foreign direct investments, social development, social impact, life standards, developing country*

Introduction

It is well known that foreign direct investments determine economic benefits for the host country and also, for the investors' country. Regarding the benefits for the host country, here we can mention technological development, increased employment and higher competition between the economic actors. In this context, the investing country receives the biggest part of the profit (earnings are repatriated), because it has the main office of the company. But, the impact of foreign direct investments goes beyond the economic field and manifests a higher impact in the society, being influential in terms of political, social, cultural, educational or environmental effects.

The impact of foreign investments can be seen as a catalyst because of its capacity for influencing society as a whole, which is transforming foreign capital into a positive adjunct in the development. Nevertheless, it is important to mention that this can also have a negative impact in the society. So, as the globalization continues to increase and the developing countries are fighting to attract more foreign investors, the negative social consequences of investments are possible to appear. In the context of moving a company from a country to another one because of the financial benefits of the investor (less taxes), the old host country will face for sure not only financial volatility, but also job losses, cultural tensions and political unrest.

This article is focused on the hypothesis that inflows of foreign direct investments have a noticeable social impact on a developing country and will try to understand how this fact influences the welfare state. Thereby, two main research questions are to be

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asked: (1) Is this social impact positive or negative in nature? And (2) What are the current trends of the relation between investment flows and societal development? In order to depict an image as accurate as possible, the main concern of this paper will be to identify the most important factors that determine the social impact of FDI.

Is the social impact a significant actor?

The economic benefits of FDI inflows are easier to be demonstrated by using quantitative data like GDP, number of employees, profit, fiscal value, while the contribution to social development is more difficult to be quantified. Global foreign direct investment inflows fell by 16 per cent in 2014 to \$1.23 trillion, down from \$1.47 trillion in 2013. The decline in FDI flows was influenced mainly by the fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks (UNCTAD, 2015, p. 2). More than that, economic advantages are easier to be obtained without realizing higher social progress. This is the case when investors and governments are looking only for a rapid economic growth, when the host country is facing real poverty or corruption problems, and when the investments are disproportionately targeted to certain industries such as natural resources.

From a long time ago, foreign investments were more oriented towards natural resources and extraction because of the advantages of these practices. Why investments in industries like natural resources determine most of the time only economic benefits? It is happening because this type of investments is not always taking care about protecting the environment of the host country and can lead to high levels of pollution, it is creating jobs for a specific group of employees (most of them are men) and is looking for a higher profit in a short period of investment, without being sustainable. Consequently, when the investor is looking for a rapid economic growth, the social benefits are moved on the second place, which demonstrates that not all investments are equal and have the capacity to maintain the cycle of benefits between economy and society.

A study developed by Deloitte UK¹ in association with Social Progress Imperative², demonstrates how making smarter strategic investments specific policies focused on driving social progress can attract FDI, which in turn advances both economic and social development³. The report concluded that social progress factors such as infrastructure, education, and personal and political security can help attract overseas investment. In the same time, foreign direct investments are able to sustain a country's future social progress through specific support – such as investments in healthcare and education – and indirectly through employment and higher incomes⁴.

¹ Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries.

² The Social Progress Imperative is registered as a non-profit organization in the United States, and its mission is to improve the lives of people around the world, by advancing global social progress by: providing a robust, holistic and innovative measurement tool—the Social Progress Index; fostering research and knowledge-sharing on social progress; and equipping leaders and change-makers in business, government and civil society with new tools to guide policies and programs.

³ Deloitte UK Company, *How social progress develops with and helps attract foreign direct investment*, available at [<http://www2.deloitte.com/global/en/pages/about-deloitte/articles/social-progress-helps-attract-foreign-direct-investment.html>], accessed: 24 April 2016.

⁴ *Ibidem*.

It is easy to move the border between economic impacts to the social ones. Good consequences for the society are able to come only if exists a sustainable economic development of the foreign investments. These two consequences are in a mutual relation, are influencing each other. No investor will come in a country without a secure work climate and where there are no specific laws created to sustain the investments. But how to attract foreign investors? First of all, by creating a favorable investment climate. By being favorable, a climate investment is characterized by aspects as political stability, favorable laws for investors, young and well prepared workforce.

The benefits of FDI are numerous and in some cases offset the negative impact. FDI inflows can result in technology transfers, human capital formation, international trade integration, an increase in competitive business environments, enterprise development, economic growth, and improved environmental and social conditions (OECD, 2002, p. 1). Regarding the benefits for the society in the host country, it is not always facing a sustainable positive impact because most of the investments are creating positive consequences only for the period of implementation. An example of a positive long term effect is represented by trainings and courses for the employees. This is a spillover effect because the investor is looking to improve the education level of an employee in order to develop a better development of the company. But, if it happens to move the company to another host country, the trained employee remains with no job, but still with the skills obtained in the education process.

One of the most remarkable effects of foreign direct investments on society concerns the quality of the labor conditions. An investment produces positive social consequences if it is capable to create equal work opportunities for men and women, if it is interested to invest in education and new technology in order to sustain the employees, and if is respecting human rights, the environment and the law.

While generally perceived as beneficial for local development of the host country, foreign direct investments has also raised concerns about unfair competition and about the workers' rights. Usually, the foreign investors tend to provide a better pay than their domestic counterparts, and that is due to the fact that wages in developing economies are smaller than in the origin country. This may happen because the productivity advantage of foreign investors spills over to local firms or because the employment activities of foreign owned firms affect the local labour market (Arnal et al., 2008, p. 20).

Looking for a cheaper labour force is one of the most important reasons for which foreign investors are moving part of their businesses in emerging economies. So, the positive impact of better wages is spreading to economy by having more money to spend, but it also has a social impact by rising the high standards of life and the life expectancy, by giving to the employees the opportunity to spend their revenues for traveling, relaxing, cultural events and better medical services. Countries with well paid citizens are also known as one of the biggest economies of the world, where the life expectancy is higher than in countries with small wages. But this is not necessary due to the impact of foreign investors; this is much more the contribution of their national policies. Most of the time, those state actors are the origin countries of the foreign investors. Sometimes, foreign investors may be a way for foreign firms in developed countries to supply markets in developing countries (Arnal et al., 2008, p. 14).

By implementing their goals, foreign investments increase pollution in host countries. The evidence is seen on a global scale in the environmental degradation determined by an accelerated industrialization, necessarily not only to support the society's evolution, but also by the need to feed a higher number of people. On their way of encouraging a business-

friendly environment, investors are transferring a part of their funds to corporate social responsibility (CSR). Being aware about a sustainable society, at a time of persistent crises and environmental challenges, UNCTAD is suggesting that all the investor countries should be ensured that their investment actions are oriented to a long term and socially fair development. A country which is not having strong regulatory systems for the rents of the exploitation of their resources has a small benefit from the foreign investment. In a case like this, the benefits are most often redistributed to less beneficial uses such as funding imports for consumption or investing abroad. When rents are reinvested in efficient enterprises and in long-term productive capital, the benefits of FDI could be achieved in an efficient way for the host country (Mabey & McNalley, 1998, p. 27).

The social impact of foreign investments is also released by the type of investment and cultural rules on the one hand, and also, by the origin of the investor. It is necessary to clarify that in this paper cultural rules are defined as a set of rules provided by foreign company embodied in the structure of the new one, in order to transform it into a specific personality. Cultural values and norms influence attitudes and patterns of behaviour and in this way have an impact on economic activities. Culture acts as a kind of background variable that manifests itself in attitudes and patterns of behaviour, and this is valid not only at individual level, but also at the investor's level. Not only people belong to different groups and cultures, also investments force to a specific culture⁵.

For example, in the first case, the social impact could be seen in the entrepreneurial culture promoted by the investor in the host country, which is requesting that the way of working should be adapted to the policy generated by the foreign company. Culture can influence economic activity in diverse ways: Culture is known to influence attitudes towards work and consumption. Culture has an influence on the organization of economic activity and the shaping and effectiveness of institutions, and culture also has an impact on social networks and confidence building within social groups (Fukuyama 2001, p. 3132). There is no known definition for entrepreneurial culture, but in this study we refer to practices promoted by an investor when we refer to this topic. The consequences can determine two directions: the entrepreneurial culture can be easily accepted and well applied by the employees in the host country, or could face rejection or misunderstanding. In the second case, the mother company faces a crisis and if is not able to fix it, it may be forced to quit the activity in that host country. As a rule, it cannot be scientifically substantiated that programmes launched to enhance "entrepreneurial culture" or to improve foundation on-related attitudes actually lead to more business foundations (Storey 2003, pp. 181-202). So, what matters for a company? In practice, the foreign company is preoccupied to obtain a higher performance for the employees and for itself, but also, to maintain a good working environment. To achieve these goals, the company is investing in human resources by implementing with them various training methods, in order to develop specific skills. Also, if a company wants to survive in a traditional society, it should to adapt its profile to specific requires. It is the case of McDonalds which is not selling products made of cow meat in India.

The origin of the investor could cause social and cultural tension between the home country and the host country, but at the same time, a diplomatic friendship could be an important advantage in the negotiation process. In this case, a good example is the relation between Romania and France, based not only on economic benefits, but also on a

⁵ Organization for Economic Co-operation and Development, *Entrepreneurial culture and attitudes*, available at [<http://www.oecd.org/site/cfecpr/42202841.pdf>], accessed 29 April 2016.

traditional diplomatic relationship, built over time. Also, without a stable political structure, foreign investments could be seen as an extension of imperialism. In more traditional cultures, rapid urbanization is seen as a threat to the local culture, so, an increase in FDI can lead to political conflict in the host country (Rothgeb, 2002, p. 36).

In the last years, the number of foreign investors is increasing in Eastern and Central Europe countries due to the fact that those state actors are trying very hard to adopt their politics, educational programs and infrastructure to the level of democratic countries from the Western Europe. The level of attractiveness of those actors is similar for the entire area. For example, according to *The Global Competitiveness Report 2013-2014*, Romania is situated on the 76 position, which is similar with the neighbourhood countries, and is not really a privileged one for the development of the country. In consequence, without touching a certain level of social development, where the markets are also well developed, a country will not be able to benefit from foreign investments presence, and the positive effects on the economic growth will be also less significant. Foreign investors alone cannot solve the problems of poverty, political instability and underdevelopment; these problems stretch far beyond the limited capacity of corporations. Another example is the experience of countries in East-Asia which shows that developing countries that use FDI purposefully by formulating and implementing national and technological development policies, will be successful in their efforts (Herman et al., 2005). The big challenge for an economy is to realize a strong combination of foreign investors and social policies in order to achieve a reduction of human rights abuses, environmental degradation, cultural tensions and financial volatility.

A lot of new products are entering into the market as a consequence of foreign direct investments. This fact has a powerful social impact because people can enjoy other products, which most of the time are quality goods for the host country, but for the investor, a new market is a new way to extend the business.

Owing to social impact of larger FDI, a country has the opportunity to obtain a better life standard by positive changes made in the educational system. This is possible by creating partnerships between companies and universities from the mother country with those from the host country. Supporting the education, which means accessibility to international programs for students, ending with foreign degrees and certificates, the country's attractiveness for foreign investors will grow due to the larger number of professionals. In consequence, it could stop the brain-drain issue by giving them the opportunity to work on high standards and to live properly with a satisfactory salary. Also, an increased number of educated people and of good working places will contribute to the liberalization of labour in developing country and the wage earnings will certainly be reduced. There is a complex relationship between foreign direct investment and human rights, between the ways in which FDI impacts society both negatively and positively. It is the interaction of governments and foreign companies that will lead to economic growth and social prosperity through FDI (Spar, 1999, p. 55).

Long term benefits to society are not able to develop only by having a high number of foreign investors. In order to provide positive social effects, the host country should ensure about an entire framework composed by legislative, political, social, institutional and even educational aspects, due to the capacity of those elements to influence each other. Recommendations for reforms about their actions are also made to the foreign investors. Such examples include multilateral agreements for corporate conduct, policy frameworks for social and environmental standards, programs for

education and workforce training, and improvement of the internal political climate by the host government (Herman, 2005).

Conclusion

In the absence of favourable conditions in the host country economy, attracting foreign investors is a more difficult task. Positive effects on the economic and also on the social level are more likely to appear, if the host country promotes a set of rules and reforms designated to protect against the negative ones.

What makes it different from the economic point of view is that social impact can't be empirically verified: culture, education or work satisfaction cannot be measured directly. In economy, foreign direct investments are seen as a driver for development of the host country because it has a lot of positive contributions by bringing advanced technology, capital, know-how and specialists. Moreover, it creates new jobs, with good salaries, and gives access to new markets.

The social impact of foreign investments can vary from country to country due to specific traditions, own social customs, religion, political regime or types of laws. In this regard, it can be higher or not, but it determines major reforms in domestic policies in order to obtain a rapid economic growth and a sustainable social development.

Choosing to invest in a country because of its financial benefits could determine also social progress, but this is a cycle because a good social climate has also the capacity to attract important investments. These two coordinates are in a mutual relation most of the time. The best case scenario is when different elements of social progress evolve at the same time with the economic development, being symbiotic, not conflictual.

In conclusion, the right policies can attract foreign direct investments and in this way social progress can be achieved, which in turn can be used to drive further progress. Combating corruption, improvements in political rights and a fair financial practice, can have a beneficial effect to increase foreign investments and to generate a positive social climate.

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