
The Role of Direct Investment in Shaping Foreign Trade (in the Case of Countries)

Norkobilov Akobir

Doctoral student of Denau Institute of Entrepreneurship and Pedagogy

Abstract: Direct investment plays a significant role in shaping foreign trade by influencing the movement of goods, services and capital between countries. This article explores the various ways in which direct investment impacts foreign trade, such as increasing trade volume, facilitating technology transfer, diversifying exports, creating jobs, and enhancing market access. By establishing production facilities, distribution networks, and sales outlets in foreign markets, direct investment can stimulate economic growth, promote innovation, and foster international trade relations. The transfer of technology and expertise from investing countries to host countries can lead to improved competitiveness and productivity, while job creation and market expansion can enhance a country's export capabilities.

Key words: Direct investment, foreign trade, trade volume, technology transfer, export diversification, job creation, market access, economic growth, innovation, global cooperation.

Introduction

Direct investment plays a pivotal role in shaping the landscape of foreign trade, exerting a profound impact on the intricate web of economic relationships between nations. As globalization continues to gather momentum, the movement of goods, services, and capital across borders is increasingly underpinned by the activities of direct investment. This research paper seeks to explore and elucidate the multifaceted ways in which direct investment influences foreign trade, delving into its potential to amplify trade volumes, facilitate the transfer of technology and expertise, diversify export portfolios, create new employment opportunities, and enhance market access.

By establishing a physical presence in overseas markets through the setting up of production facilities, distribution channels, and sales outlets, direct investment acts as a catalyst for economic growth and development. Through these investments, countries can leverage their unique strengths and capabilities to tap into new markets, driving exports and creating a ripple effect of prosperity. Moreover, the transfer of knowledge, technology, and best practices from investing countries to host countries through direct investment can foster innovation, enhance competitiveness, and boost productivity, ultimately contributing to the overall economic advancement of the latter.

Job creation is another significant outcome of direct investment, as the establishment of new businesses and expansion of existing operations in foreign markets lead to the creation of employment opportunities for the local workforce. This not only boosts domestic consumption but also strengthens the export potential of the host country by increasing the pool of skilled labor available for production and trade activities. Furthermore, direct investment facilitates market access by providing companies with a foothold in foreign markets, enabling them to navigate regulatory barriers, cultural differences, and logistical challenges more effectively, thus expanding their reach and market share.

In examining the role of direct investment in shaping foreign trade, it becomes evident that this phenomenon is not merely a transactional exchange of capital but a strategic tool for driving economic development and fostering international cooperation. By fostering greater integration and collaboration between economies, direct investment serves as a conduit for the sharing of resources, knowledge, and opportunities, ultimately contributing to a more interconnected and prosperous global economy. Through a comprehensive exploration of these dynamics, this article aims to underscore the crucial importance of direct investment in shaping the future of foreign trade and economic relations.

Literature Review

Scholars and researchers have delved into various aspects of direct investment, elucidating its implications for trade volumes, technology transfer, export diversification, employment generation and market access. This literature review aims to provide a comprehensive overview of key studies and findings related to the role of direct investment in shaping foreign trade.

One key area of research focuses on the relationship between foreign direct investment (FDI) and trade flows. Studies such as Blomstrom, Lipsey, and Zejan have highlighted the positive correlation between FDI inflows and export performance, indicating that multinational corporations (MNCs) often use their overseas operations to access new markets and expand their export capabilities [Blomstrom, Lipsey, and Zejan, 1994]. Similarly, Alfaro and Rodriguez-Clare have demonstrated that FDI can lead to increased trade in intermediate goods, as MNCs establish cross-border supply chains to optimize production processes [Alfaro and Rodriguez-Clare, 2004].

The literature also emphasizes the role of direct investment in technology transfer and knowledge spillovers. As foreign companies invest in host countries, they often bring with them advanced technologies, managerial practices, and industry expertise, which can enhance the productivity and competitiveness of local industries. Dunning has argued that FDI can serve as a conduit for the transfer of tacit knowledge and skills, leading to long-term improvements in the host country's technological capabilities [Dunning, 1993].

Furthermore, studies have examined the link between direct investment and export diversification. UNCTAD points out that FDI can help countries diversify their export base by fostering the development of new industries and export sectors. By investing in sectors with high growth potential and comparative advantages, foreign companies can contribute to the expansion and diversification of a country's export portfolio, reducing its reliance on a few key products or markets [UNCTAD, 2017].

The literature also underscores the role of direct investment in job creation and labor market effects. Blalock and Gertler have highlighted the positive impact of FDI on employment generation in host countries, particularly in manufacturing and service sectors. Direct investment not only creates new job opportunities but also contributes to the transfer of skills and knowledge to the local workforce, enhancing their employability and productivity [Blalock and Gertler, 2008].

Moreover, researchers have explored how direct investment can facilitate market access for businesses operating in foreign markets. Rugman and Verbeke, argue that FDI can help firms overcome trade barriers, regulatory hurdles, and cultural differences that may impede market entry and expansion. By establishing a physical presence in overseas markets, companies can build relationships with local suppliers, distributors and customers, gaining a competitive advantage and enhancing their market reach [Rugman and Verbeke, 2007].

Research methodology

To investigate the role of direct investment in shaping foreign trade, a mixed-methods research approach will be employed, combining quantitative analysis of trade and investment data with qualitative examination. The research methodology will include data structures such as data collection, data analysis, comparative analysis and policy implications. By employing a mixed-

methods research approach, this study aims to provide a comprehensive and nuanced understanding of the role of direct investment in shaping foreign trade dynamics, thereby contributing to the existing literature and informing evidence-based policy decisions in the field of international trade and investment.

Analyzes and results

In today's globalized economy, business relationships go beyond just trading goods and services, with a growing reliance on various forms of industrial organization such as foreign affiliates, overseas investments, mergers, joint ventures, subcontracting, offshoring, and licensing agreements. Foreign direct investment (FDI) is a key economic strategy that is explored in this article.

Some economists believe that FDI establishes stronger connections between economies compared to international trade, leading to the transfer of technology and expertise, enhancing productivity, and increasing competitiveness. Governments often prioritize attracting FDI based on economic benefits, as it is seen as a way to stimulate economic growth and create job opportunities.

Conversely, some economists present opposing viewpoints, emphasizing how certain multinational corporations may exploit resources or take advantage of lower labor and environmental standards in host countries. Additionally, there is a significant body of literature addressing corporate responsibility, ethics, and strategies used by multinational enterprises to optimize or avoid taxes. This has sparked ongoing debates around the intentions and redistribution effects of Foreign Direct Investment (FDI).

Data for global and non-European Union countries has been converted from US dollars to euros. FDI flows are measured using annual average exchange rates, while FDI stocks are measured at the end of each year, with more detailed statistics collected quarterly. FDI stocks reflect the total value held at the end of the reference period, incorporating the value at the beginning of the year, adjusted for transactions that occur during the year, as well as changes in other position values due to factors like exchange rate fluctuations.

In 2021, the global FDI stock was valued at €38.5 trillion (€38,500 billion) based on both inward and outward positions. Europe was identified as the largest source and recipient of FDI stocks globally. The United Nations reported that over one-third (36.2%) of global inward investment was concentrated in Europe (€14.5 trillion), while Europe accounted for more than two-fifths (42.2%) of the world's outward investment stocks (around €15.6 trillion).

From 2011 to 2019, there was a notable decline in the proportion of global FDI stocks located in Europe, with its share decreasing by 6.2 percentage points. However, there was a significant shift in 2020, partially due to the impact of the COVID-19 crisis, as investment stocks in Europe experienced rapid growth - Europe's share increased by 2.8 percentage points between 2019 and 2020. Nonetheless, the long-term trend reemerged in 2021 as Europe's share dropped to 36.2%, slightly below the 2019 level and 6.4 percentage points lower than the 2011 figure. The decline in Europe's share of global FDI stocks from 2011 to 2021 represented the most substantial drop among all continents during that period.

The proportion of FDI stocks in Latin America and the Caribbean, as well as in Oceania, Africa, and Asia, decreased over the period from 2011 to 2021, with Northern America experiencing a notable increase. Europe and Asia were the only continents identified as net investors, with Europe surpassing the value of inward FDI stocks with outward investments. Figure 1 shows significant fluctuations in Europe's share of outward FDI stocks over the decade, starting at over half of the global total in 2011 and declining to its lowest level in 2021.

In 2021, Europe held the largest share of outward FDI stocks globally, followed closely by Northern America and Asia. Over the same period, Europe experienced a considerable decline in its share of outward FDI stocks, with Oceania and Latin America also showing slight decreases,

while Africa's share remained stable. On the other hand, Asia and Northern America saw significant increases in their shares of outward FDI stocks.

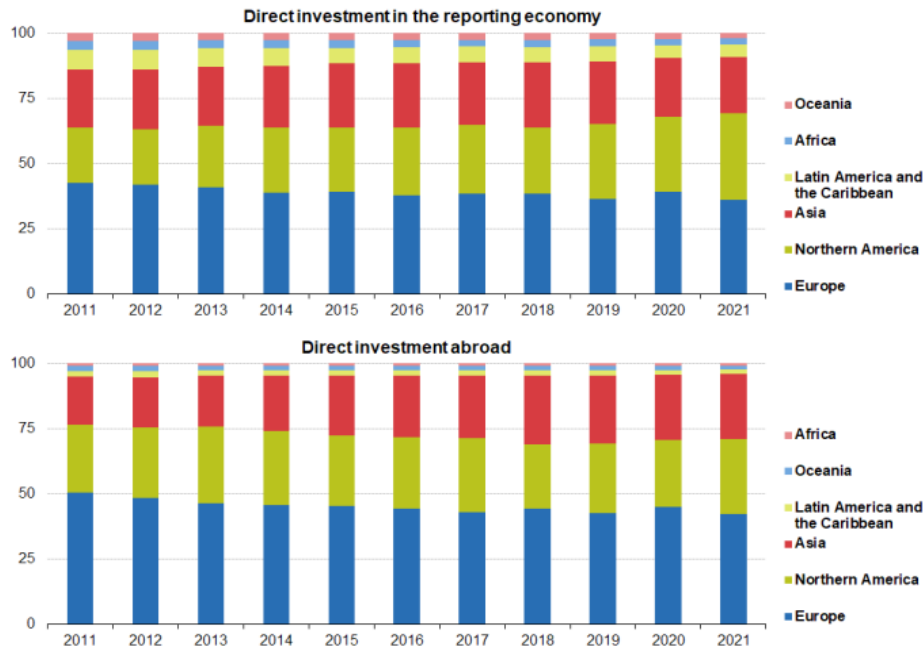


Figure 1: Stock of foreign direct investment, by continent, 2011 – 2021 (% of world total)

Source: UNCTAD (FDI/MNE database)

Figure 2 illustrates the comparison of FDI stocks with the economic size, measured by gross domestic product (GDP), of each economy. The global average in 2021 showed that outward direct investment stocks were 44.9% of GDP, while inward direct investment stocks were 48.8% of GDP.

In 2021, Hong Kong and Singapore stood out as Asian economies with high levels of 'openness' as their inward FDI stocks greatly exceeded their GDP, with direct investment stocks in Hong Kong and Singapore being 5.7 and 4.9 times their respective GDP levels. The United Kingdom also had a significant share, with inward FDI stocks representing 88.1% of its GDP. The EU's direct investment stocks were valued at 52.0% of its GDP in 2021, higher than the global average and only surpassed by Hong Kong, Singapore, the United Kingdom, Canada, and the United States in terms of the ratio to GDP.

Conversely, China and Japan had lower ratios of inward FDI stocks relative to GDP, with Chinese stocks at 12.1% and Japanese stocks at 5.4%. Japan's low inward FDI stocks were mainly due to limited foreign investment in areas other than machinery and motor vehicle manufacturing.

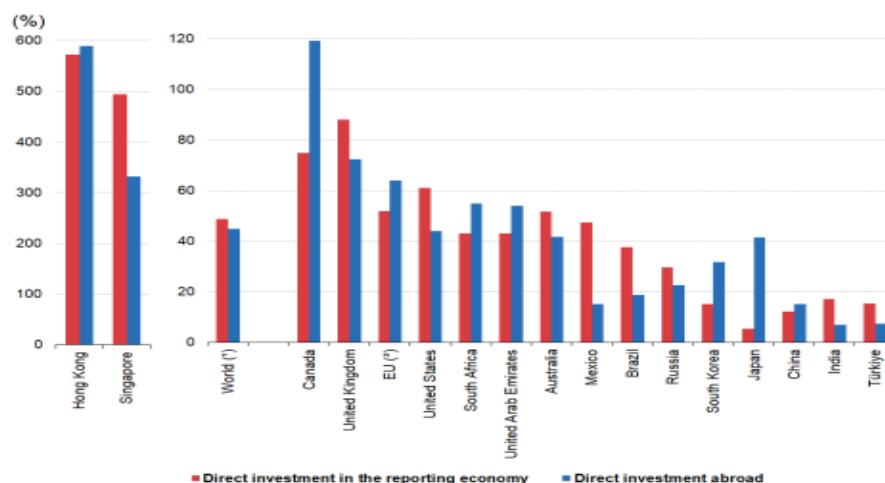


Figure 2: Stocks of foreign direct investment, relative to GDP, 2021 (%)

Source: Eurostat (bop_fdi6_pos) and (nama_10_gdp) and UNCTAD (FDI/MNE database)

Upon analyzing the relative importance of outward FDI stocks from each economy, a common trend emerges where countries with high levels of market openness to inward FDI also exhibit high ratios of outward FDI relative to GDP. This indicates a strategic approach by some economies to leverage free trade and investment opportunities for competitive advantage, while others may have a more domestically focused approach.

However, there are exceptions to this pattern. For instance, Japan had a high ratio of direct investment abroad to GDP at 41.4%, indicating a tendency for Japanese enterprises to invest in foreign operations more than foreign enterprises invest in Japan. Similarly, Canada and South Korea also had high ratios of outward FDI relative to GDP, with outward investment surpassing the size of their respective economies. In contrast, Mexico, India, Turkey, and Brazil had relatively low values of direct investment abroad compared to GDP and inward investment.

The disparity in ratios between inward and outward FDI stocks can help identify net investing economies in 2021, including Japan, South Korea, Canada, South Africa, the United Arab Emirates, China, the EU, and Hong Kong. Table 1 presents developments in both inward and outward FDI stocks, highlighting six countries where the nominal value of inward FDI stocks more than doubled between 2013 and 2021, with the United States leading in significant growth followed by India, Singapore, China, the United Arab Emirates, and the United Kingdom.

Table 1: Stocks of foreign direct investment, 2013-2021 (€ billion)

Source: Eurostat (bop_fdi6_pos) and UNCTAD (FDI/MNE database)

	Direct investment in the reporting economy									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	
World (€)	18 074	21 462	24 385	26 971	27 599	28 684	32 517	34 005	40 128	
EU (€)	4 865	5 403	6 647	7 200	7 276	6 972	7 253	7 319	7 559	
Australia	413	480	520	580	584	613	652	648	680	
Brazil	455	495	395	535	519	497	628	485	523	
Canada	712	819	741	857	787	805	1 029	1 007	1 270	
China	693	893	1 121	1 284	1 242	1 422	1 575	1 564	1 822	
Hong Kong	980	1 232	1 462	1 543	1 621	1 715	1 663	1 509	1 785	
India	164	208	260	302	315	337	380	391	454	
Japan	124	141	160	187	189	179	199	189	227	
Mexico	340	378	395	411	415	451	505	445	511	
Russia	342	239	241	374	368	366	439	360	461	
Singapore	651	847	1 003	1 086	1 187	1 330	1 548	1 591	1 772	
South Africa	110	114	116	129	130	121	129	108	153	
South Korea	131	148	165	179	191	207	215	216	232	
Türkiye	111	151	146	142	164	127	143	187	107	
United Arab Emirates	68	84	101	113	101	112	117	123	151	
United Kingdom	1 097	1 303	1 406	1 386	1 509	1 744	1 820	1 809	2 326	
United States	3 588	4 495	5 264	6 169	6 509	6 416	8 334	8 812	12 025	
	Direct investment abroad									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	
World (€)	18 270	21 004	24 303	26 567	27 572	27 417	30 707	32 227	36 905	
EU (€)	6 150	7 050	8 512	9 145	8 634	8 737	9 287	8 761	9 306	
Australia	331	385	383	413	420	435	517	508	546	
Brazil	148	173	170	193	203	186	220	226	262	
Canada	834	963	1 062	1 224	1 282	1 194	1 483	1 587	2 018	
China	479	727	1 008	1 288	1 508	1 731	1 957	2 103	2 280	
Hong Kong	900	1 194	1 407	1 467	1 512	1 598	1 606	1 565	1 839	
India	87	108	128	137	129	145	160	156	182	
Japan	811	949	1 129	1 248	1 249	1 370	1 585	1 497	1 752	
Mexico	106	125	132	142	151	140	156	154	164	
Russia	279	274	266	325	324	303	363	311	353	
Singapore	452	561	680	787	896	859	1 019	1 031	1 189	
South Africa	93	120	142	167	228	215	191	205	194	
South Korea	173	215	263	294	301	354	406	408	487	
Türkiye	24	33	33	37	38	39	44	41	51	
United Arab Emirates	50	67	90	105	104	146	164	157	190	
United Kingdom	1 302	1 385	1 475	1 488	1 542	1 611	1 750	1 742	1 913	
United States	4 535	5 206	5 586	6 067	6 558	5 584	6 747	6 716	8 685	

The rate of growth was particularly fast in terms of the amount of Chinese foreign investment stocks in 2021, which were 4.8 times higher than in 2013. It is important to recognize that the overall value of these stocks was relatively low in 2013 compared to the levels seen in the EU or the United States. The United Arab Emirates, South Korea, Singapore, and Canada also experienced significant growth rates in their outward FDI stocks.

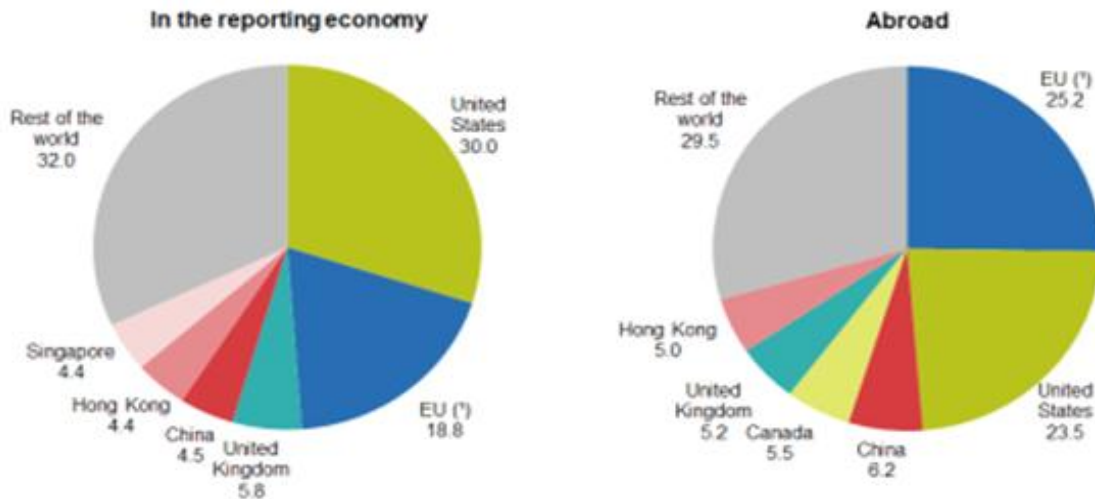


Figure 3: World stocks of foreign direct investment, 2021 (% of total)

Source: Eurostat (bop_fdi6_pos) and UNCTAD (FDI/MNE database)

The final section presenting data on inward and outward foreign direct investment stocks focuses on the distribution of these stocks among the key global players (refer to Figure 3). In 2021, approximately 18.8% of the global inward investment stocks were located within the European Union, while its share of global outward investment was slightly higher at 25.2%. The EU had the highest share of outward FDI stocks in 2021 and the second highest share of inward stocks, while the United States held the highest share of inward stocks and the second highest share of outward stocks. The United Kingdom held the third largest share of global FDI stocks in terms of inward investment, with China having the third largest share for outward investment.

Summary and Recommendations

Direct investment plays a crucial role in shaping foreign trade by creating strong economic linkages between countries. Foreign direct investment (FDI) can lead to increase trade between the investing country and the host country, as well as stimulate the growth of domestic industries and supply chains. FDI can also help improve efficiency and productivity in the host country, leading to increased competitiveness in global markets. Additionally, direct investment can result in technology transfer, skill enhancement, and knowledge spillovers, which can further boost foreign trade and economic development.

As for the recommendations, governments should create a conducive environment for foreign direct investment by implementing policies that promote ease of doing business, provide incentives for investors, and ensure stability and predictability in the business environment. Governments should also encourage foreign investors to form partnerships with local firms, as this can help in transferring technology, knowledge, and skills to the local workforce, thereby enhancing the competitiveness of domestic industries in global markets.

Moreover, governments should invest in infrastructure development and human capital to attract more foreign direct investment and enhance the productivity and competitiveness of their economies. Additionally, they should prioritize the negotiation of trade agreements and partnerships with other countries to reduce trade barriers, promote greater market access, and create new opportunities for foreign trade through direct investment.

References

1. Blomstrom, M., Lipsey, R. E. and Zejan, M. (1994) "What Explains Growth in Developing Countries?". NBER Discussion Paper no. 1924.
2. Andres Rodriguez-Clare and Laura Alfaro. (2004). "Multinationals and Linkages: An Empirical Investigation". 2004 Meeting Papers from Society for Economic Dynamics.

3. Dunning, J.H. (1993). "Multinational Enterprises and the Global Economy". Addison Wesley, New York.
4. Garrick Blalock and Paul Gertler. (2008). "Welfare Gains From Foreign Direct Investment Through Technology Transfer to Local Suppliers". March 2008. Journal of International Economics 74(2):402-421. DOI:10.1016/j.jinteco.2007.05.011
5. Alan M. Rugman and Alain Verbeke. (2007). "Liabilities of Regional Foreignness and the Use of Firm-Level versus Country-Level Data: A Response to Dunning et al.". Journal of International Business Studies.
6. <https://unctadstat.unctad.org>
7. <https://ec.europa.eu>