THE ROLE OF FOREIGN INVESTMENTS IN THE CONTEXT OF THE COUNTRY'S ECONOMIC DEVELOPMENT

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Abstract

In a modern economy, investment activity is one of the main factors of economic development, structural changes and increased competitiveness. A significant part of the countries of the world strive to attract and encourage foreign investments to strengthen productive capacities and sustainable economic development. And for a foreign direct investor, the primary motive for investment is the establishment of long-term relations with the host enterprise, provided that it has a significant influence on its management, as well as increasing profits, reducing taxes, diversifying risks, etc. Currently, the main subjects of foreign direct investment in the global market are international companies and financial groups.

However, in reality, foreign direct investment alone cannot guarantee the prosperity of the national economy. The latter, as a development tool, has both its advantages and disadvantages, and in the host country, they contribute to sustainable economic growth only if certain conditions are met. In this regard, the government of the host country is responsible for establishing conditions for foreign direct investment that will contribute to the long-term economic growth of that country, and not only to ensuring the profits of foreign investors. Therefore, the impact of foreign direct investment on the host country depends on many factors, such as the method of entering the market, the sources of financing for direct investment, the latter's impact on the activities of companies operating in the host country, etc.

On the other hand, regardless of the volume of foreign investment, it can also be completely useless and lead to the ruthless waste of the country's natural resources, as well as the population's dependence on the outside world for many years. Only with a balanced and considered approach to the joint interests of investors and the host country can it be ensured that foreign investments are effectively attracted and utilised for the benefit of the country's economic prosperity and the improvement of the population's living standards.

Keywords: Foreign direct investment, digital economy, enterprise.

ՕՏԱՐԵՐԿՐՅԱ ՆԵՐԴՐՈՒՄՆԵՐԻ ԴԵՐԸ ԵՐԿՐԻ ՏՆՏԵՍՈՒԹՅԱՆ ԶԱՐԳԱՑՄԱՆ ՀԱՄԱՏԵՔՍՏՈՒՄ

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ՀՀ Գիտությունների ազգային ակադեմիայի
գիտակրթական միջազգային կենտրոնի
տնտեսագիտության և կառավարման ամբիոնի հայցորդ

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Համառոտագիր

Ժամանակակից տնտեսությունում ներդրումային գործունեությունը տնտեսական զարգացման, կառուցվածքային փոփոխությունների իրականացման և մրցակցության աճի հիմնական գործոններից մեկն է: Աշխարհի երկրների զգալի մասը ձգտում է ներգրավել և խրախուսել օտարերկրյա ներդրումները՝ արտադրողական կարողությունների ամրապնդման և տնտեսության կայուն զարգացման նպատակով: Իսկ օտարերկրյա ուղղակի ներդրողի համար ներդրման հիմնական շարժառիթը ներդրում ընդունող ձեռնարկության հետ երկարաժամկետ հարաբերությունների հաստատումն է՝ վերջինիս կառավարման վրա նշանակալի ազդեցություն ունենալու պայմանով, ինչպես նաև շահույթի մեծացումը, հարկերի կրճատումը, ռիսկերի դիվերսիֆիկացումը և այլն: Ներկայումս համաշխարհային շուկայում օտարերկրյա ուղղակի ներդրումների հիմնական սուբյեկտները միջազգային ընկերություններն ու ֆինանսական խմբերն են:

Սակայն, իրականում, միայն օտարերկրյա ուղղակի ներդրումներն չեն կարող երաշխավորել ազգային տնտեսության բարգավաճումը: Վերջիններս, որպես զարգացման գործիք, ունեն ինչպես իրենց առավելությունները, այնպես էլ թերությունները, ընդունող երկրում դրանք նպաստում են տնտեսական կայուն աճին միայն որոշակի պայմանների ապահովման պարագայում: Այս առումով՝ ընդունող երկրի կառավարությունը պատասխանատու է օտարերկրյա ուղղակի ներդրումների համար սահմանել այնպիսի պայմաններ, որոնք կնպաստեն այդ երկրում երկարաժամկետ տնտեսական աճին, այլ ոչ միայն օտարերկրյա ներդրողների շահույթի ապահովմանը: Հետևաբար, օտարերկրյա ուղղակի ներդրումների ազդեցությունն ընդունող երկրի վրա կախված է բազմաթիվ գործոններից, ինչպիսիք են՝ շուկա մուտք գործելու եղանակը, ուղղակի ներդրումների ֆինանսավորման աղբյուրները, վերջիններիս ազդեցությունն ընդունող երկրում գործող ընկերությունների գործունեության վրա և այլն:

Մյուս կողմից, անկախ օտարերկրյա ներդրումների ծավալից, վեր-

ջիններս կարող են նաև լիովին անօգուտ լինել և, հանգեցնել երկրի բնական ռեսուրսների անխնա վատնման և երկար տարիներով ազգաբնակչությանը արտաքին աշխարհից կախվածության: Միայն ներդրողների և ընդունող երկրի համատեղ շահերի հավասարակշռված և կշռադատված մոտեցմամբ է հնարավոր երաշխավորել օտարերկրյա ներդրումների արդյունավետ ներգրավումն ու օգտագործումը ի շահ երկրի տնտեսության բարգավաճման և ազգաբնակչության կենսամակարդակի բարձրացման:

Բանալի բառեր՝ օտարերկրյա ուղղակի ներդրումներ, թվային տնտեսություն, ձեռնարկություն:

Introduction

From the point of view of ensuring the development of the economy and the expanded reproduction process, ensuring stable flows of investments from various sources is of vital importance for any country. A significant part of the countries in the world strive to attract and encourage foreign investments to strengthen productive capacities and develop the economy sustainably. In this regard, the latter are improving national regulations in the field of foreign investment, making industrial policy more targeted in strategic sectors of the economy, as well as establishing clear and detailed procedures for attracting and selecting companies that implement foreign investments. Of course, in some cases, there are risks that some of the listed measures are taken with protectionist goals in mind for the national economy (Blonigen et al., 2007).

Foreign direct investment (FDI) is investment made by non-resident investors in enterprises in a given foreign country, and the reasons for making foreign direct investment are diverse.

FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated. Individuals as well as business entities may undertake FDI. Flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an enterprise, or capital received from an investing enterprise by a foreign direct investor.

The share of foreign direct investment in the economy is growing. If in the 1970s it was only 6%, then in the 1990s about 20-25% of the total investment flow fell on foreign direct investment (UNCTAD,1999).

The specific reasons for the export and import of foreign capital are largely the same, despite the differences in their relative roles.

The main impetus for the intensive development of the investment process for business is the need to increase their competitiveness at the international level by expanding operations in new markets, rationalizing production, reducing costs, diversifying risks, and ensuring access to resources and strategic assets in the economies of different countries.

The objectives of direct investment differ from the objectives of portfolio investment, in which investors usually do not seek to influence the management of the enterprise, but rather pursue profit-making and risk diversification.

Foreign direct investment has several advantages for the host country compared to portfolio investment. First, it activates the private sector. Host companies receive a new spur for their activities and additional resources, which, due to the multiplier effect, are spread to their domestic partners. Second, through FDI, it is sometimes easier to enter new markets. Host companies get the opportunity to use the capabilities of the investing company in the distribution of products. Third, it facilitates access to new technologies and management methods. The investing company is typically interested in modernising production and developing enterprise management technologies. When receiving direct investment, the probability of reinvesting profits within the country is higher. Conversely, when making a portfolio investment, the probability of exporting profits to the home country is higher. Direct investment relations, by their nature, can lead to long-term, stable financing and technology transfer, thereby increasing corporate output and returns over time. Portfolio investors do not seek to establish long-term relationships, and the main factor influencing the decision to buy or sell securities is their profitability.

Theory and Methodology

The existence of different theories in the field of foreign direct investment research has led to varying views on the role of foreign direct investment in economic development.

Investment activity is a set of measures taken by legal entities, individuals or the state to implement investments aimed at increasing capital, achieving profit or other positive results (Zakharova, 2015).

According to the definition formulated by the EBRD, foreign direct investment is a type of international investment that is made by a foreign resident (direct investor) based on long-term interest in the capital of an enterprise resident in a country other than the country of the direct investor (enterprise receiving direct investment or recipient)(OECD,2008).

According to the International Monetary Fund (IMF) methodology, foreign direct investment can be considered as investments that involve the acquisition of at least 10% of the authorized capital of a commercial organization in the territory of the host state and allow the investor (or its representative) to have a strategic influence on the management of that organization, including partial or full control over them(IMF,2004).

However, in practice, a 10% share in the authorised capital of the recipient organisation is often still insufficient to establish effective control over the company's management or to ensure the long-term interests of the investor. Therefore, direct investments should generally be significant enough and long-term enough to allow the foreign investor to establish effective control over the management of the recipient company and to ensure long-term interests in the successful operation and development of the latter. At the same time, the long-term nature of capital investments within the framework of foreign direct investments limits the opportunities for investors to exit the market quickly and thereby increases the interest of host countries in FDI.

FDI has three components: equity capital, reinvested earnings and intra-company loans.

- Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
- Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
- Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises (UNCTAD,2007).

In general, horizontal and vertical forms of FDI are distinguished. Horizontal investment involves the organisation of production in another country of almost the same goods and services as those produced in the home country. For example, if a soft drink company opens a new factory abroad, this is a horizontal investment. Horizontal investment is usually accompanied by expansion by the parent company and large-scale FDI investments in the host country's economy. Horizontal foreign direct investment is preferred by the organisation when selling goods to foreign markets is too expensive due to transportation costs and trade barriers (Prostenko, 2003).

Vertical FDI refers to international companies that divide the production process along geographical lines. They are called vertical, because international corporations divide the production chain vertically, controlling some stages of production abroad. The peculiarity of such a division is that the production process includes many stages of production that require the availability of different input materials. If the prices of these components differ by country, then it will be beneficial for the company to divide the production chain by those countries.

In the case of vertical reverse foreign direct investment, an enterprise is established abroad by the investing company as its own supplier of production factors, providing the parent company with the necessary components. Primary investments are directed to foreign branches of transnational corporations that receive the necessary components for their own production from the parent company and, thus, stand behind the parent company in the production chain. A single transnational corporation often employs both types of investments, which is explained by the varying costs of the necessary components in different countries (Aizenman & Marion, 2003).

Research Methods

Research methods applied within the investigation framework of the article include universal scientific methods such as dialectical, systematic, comparative analysis, historical-logical, structural-functional, statistical, and comparative methods.

Results

In 2024, global foreign direct investment (FDI) flows totalled$1.4 trillion, a 1% increase compared to 2023. However, this growth is less impressive when considering the influence of large transactions through European conduit economies, which often serve as transfer points for investments. Excluding these flows, FDI actually fell by 9%(UNCTAD, 2025). Overall, the share of FDI in global investments is being influenced by a complex interplay of international and regional factors, with some areas experiencing growth while others are contracting. High borrowing costs and exchange rate volatility continue to deter long-term infrastructure investment, especially in the least developed countries. And multinationals are restructuring supply chains towards South-East Asia, Eastern Europe and Central America – a shift that began during the pandemic and is accelerating. FDI to developed economies fell by 22%. Europewas hit hardest, with inflows down 58% in 2024. FDI fell in more than half of EU countries, with sharp declines in Germany (-89%), Spain (-39%), Italy (-24%) and France (-20%). North Americasaw a 23% rise, driven by a wave of semiconductor megaprojects in the United States, where FDI rose 20%. Asiaremained the top recipient region, despite a 3% overall decline and a 29% drop in flows to China. South-East Asia stood out, with ASEAN countries up 10%, reaching a record $225 billion in FDI. India saw strong momentum in greenfield investment, even as total inflows dipped slightly (UNCTAD, 2025). FDI flows in G20 non-OECD economies dropped by 30%. China saw a continued decline for the third consecutive year and received less FDI than India and Indonesia (with Indonesia being the only G20 non-OECD economy to report an increase in FDI inflows) (UNCTAD,2025).

The United States remained the top destination for FDI inflows worldwide in 2024 (USD 308 billion), followed by Luxembourg (USD 106 billion) and Canada (USD 64 billion). FDI outflows from the OECD area increased by 9%, but fell by 14% when excluding large fluctuations from the European countries. The United States experienced the largest drop in FDI outflows in the OECD, with foreign affiliates extending loans to their US parents. In contrast, Japan reported higher FDI outflows, mostly in the form of equity flows. In the EU area, FDI outflows almost tripled compared to 2023. However, when excluding volatile outflows from selected EU countries, they declined by 16%. The largest decreases within the EU were observed in France and Germany, due to movements in intra-company loans. FDI outflows from G20 non-OECD economies dropped by 25% in 2024. The most significant declines were recorded in China and, to a lesser extent the Russian Federation, likely reflecting reduced new investment activity and, in the case of China, changes in intra-company loans.6 Brazil also reported lower FDI outflows, as foreign affiliates increased lending to their Brazilian parents. In 2024, the United States (USD 299 billion), Japan (USD 204 billion) and China (172 billion) were the primary sources of FDI outflows worldwide (UNCTAD, 2025).

The development of the digital economy currently has a significant impact on global investment flows. FDI flows mainly to countries with a high level of scientific and technological progress and highly qualified specialists. The volume of FDI in the digital economy has amounted to about $122 billion annually in recent years. Between 2021 and 2023, the sector received 8.3% of global FDI on average – up from 5.5% between 2012 and 2014. For developing economies, average annual FDI flows to the digital economy nearly doubled over the same period. Globally, the growth has been driven by expanding digital services, rising demand for software solutions and emerging tech talent and start-up ecosystems. Investment in the digital economy brings clear benefits, including better infrastructure, skilled jobs, technology transfer, and more dynamic innovation ecosystems. But many low-income countries remain locked out. Infrastructure gaps, high investment risks and weak regulatory frameworks continue to deter capital.

As for FDI regulation, in 2024, investment policymaking was pulled in two directions: the need to attract capital, and the pressure to protect national interests. Roughly 78% of new measures were labelled as favourable to investors – especially in developing countries (89%). Incentives are now the leading tool governments use to attract and steer capital where they want it. These include fiscal incentives, such as tax breaks, and financial incentives, such as grants and subsidies (UNCTAD, 2025).

In 2024, they accounted for 45% of all new measures favourable to investors – most notably in clean energy and industrial sectors. Meanwhile, restrictions tightened in strategic sectors – especially in developed economies. More than 40% of all restrictive measures in 2024 concerned screening mechanisms, which aimed to monitor foreign investment in sensitive sectors, such as high-tech and critical minerals.

More than 40% of all restrictive measures in 2024 concerned screening mechanisms, which aimed to monitor foreign investment in sensitive sectors, such as high-tech and critical minerals. The number of countries with FDI screening regimes for national security has more than doubled to 46 since 2015.

Let us consider the main macroeconomic factors influencing FDI flows, especially in the case of developing countries:

• Market capacity and growth prospects of the host country. Market capacity is one of the most frequently used variables in studies to determine the factors related to the attraction of foreign direct investment. The true hypothesis of a positive relationship between FDI and market size stems from the experience of many investment-receiving countries; however, there are also researchers who argue that the market capacity of the host country and its growth rate are not the main factors in attracting foreign direct investment.

• The macroeconomic stability of the host country, as well as the effectiveness of the legal and regulatory processes in the investment sector, are important factors influencing investors' decisions.

• International trade relations. FDI usually follows trade movements at both the micro and macro levels. For example, if a company currently has a particular share of the export market, it will likely make foreign direct investment in the future. In fact, the higher fixed costs associated with a production facility located abroad (compared to exports) are compensated by lower variable costs if it is possible to ensure appropriate economies of scale. In addition, American researchers have found a significant relationship between trade between the United States and several developing countries, as well as US direct investment in these countries. In the initial stage, companies export their products to foreign markets. However, when exports reach a critical level, or in cases where they are threatened by tariff or non-tariff barriers, the exporter must launch production abroad, making appropriate direct investments in the country where the latter's products are mainly exported. Therefore, the first step is export, followed by foreign direct investment. Trade relations allow investors to gain more knowledge not only about the demand for their products in partner countries, but also to better understand the market factors of production, which are necessary for making decisions about direct investment. At the same time, geopolitical fragmentation and tensions in trade relations negatively affect investor confidence and the prospects for foreign direct investment.

• Import substitution. The fact that FDI follows international trade is also reinforced by the import substitution policy adopted by a section of developing countries. The latter is aimed at protecting local markets and producers from the influx of cheap foreign goods. In this case, foreign companies will have to invest in establishing production in a given country (depending on the size and growth prospects of that economy) to maintain that market. Sometimes, the prospect of an import substitution policy can encourage foreign suppliers to organise local production, rather than import into a given country. In fact, restrictions on import quotas, tariffs and import duties are also overcome in this way.

• Exchange rate. The effect of the exchange rate is another factor that can affect the relationship between trade and FDI. In the theory of currency zones of foreign direct investment, R. Aliber argues that companies in countries with stronger currencies can borrow at lower interest rates than companies in countries with weaker currencies. As a result, FDI moves from the former to the latter, depending on the share of capital in value added and the ratio of the currencies of the two countries. Experimental studies have been conducted to prove the relationship between FDI and exchange rate changes in host countries. According to some of them, the depreciation of the national currency stimulates the inflow of FDI and prevents its outflow. However, some other researchers argue that depreciation can have the opposite effect on FDI (Scaperlanda, 1974)[5].

• Labor and logistics costs. Foreign direct investment is also affected by the level of production costs in both the home country and potential host countries, which is influenced by the exchange rate of the currencies in force. However, history shows that Japanese direct investment in developing countries has been dependent on the labor costs of those countries, while investments from the United States, Germany and the United Kingdom have not fully followed this pattern. In addition, the growth of robotic production processes tends to reduce the role of unskilled labour. FDI, associated with the establishment of production in another country, contributes to a significant reduction in logistics costs, which makes it more profitable to produce these goods in another country.

• Access to natural resources. Foreign direct investment provides access to the natural resources of the host country on relatively affordable terms, which contributes to a decrease in the cost of production and an increase in the competitiveness of goods.

5 Scaperlanda, Anthony E., Trends, Composition and Determinants of United States Direct Investment in Canada. US Department of Commerce, Office of Foreign Direct Investments, Washington 1974

Although from the investor's point of view, there are clear motives for foreign direct investment, namely access to new markets and the availability of cheap factors of production, many third-world countries, which have quite attractive and promising markets and available resources, do not often represent much interest for foreign investors. In this case, the economic factors related to the location of foreign direct investment can be ignored if the host country is in a politically and economically unstable state. In particular, the economies of many developing countries were hit hard by the global financial and economic crises of 2008 and 2014, and as a result, lost their interest in foreign capital. Moreover, the high level of public debt in many developing countries also repels foreign investment, since in this case the real income from the latter can significantly decrease as a result of high taxes and market stagnation. Such situations can result in partial or complete loss of profit for foreign investors, as well as restrictions on the transfer of profits or capital.

Conclusion

Direct investment as a development tool has both its advantages and disadvantages, and in the host country, it contributes to economic growth only if certain conditions are met. In this regard, the government of the host country is responsible for ensuring such conditions for foreign direct investment that will contribute to long-term economic growth in that country, and not only for providing the profits of foreign investors. Therefore, the impact of foreign direct investment on the host country depends on many factors, such as the method of entering the market, the sources of financing for direct investment, the impact of the latter on the activities of companies operating in the host country, etc.

The positive effects of foreign investment include:

- growth in the volume of real capital investments, acceleration of economic development rates and improvement of the country's balance of payments,
- attraction of foreign innovative technologies, management experience and research results,
- opportunities to use local mineral resources,
- growth in employment, labor qualification and productivity,
- expansion of the product range,
- opportunities to modernize existing infrastructure,
- contributions to the country's state budget increase in tax revenues,
- increase in competition and decrease in the level of market monopolisation.

The most fundamental risks associated with attracting foreign direct investment are related to the impact of FDI on domestic competition. FDI, particularly in the form of mergers and acquisitions, negatively affects the level of competition in the domestic market of a given country. They can lead to restrictions on trade activities and the abuse of economic opportunities. Thus, large transnational corporations can harm the host country's economy by "choking out" local enterprises, utilising their finances, technology, international connections, advertising skills, and other supporting services to gain a dominant market position and drive small and medium-sized enterprises out of the market.

Foreign investment can also lead to a slowdown in technological development, as resources are directed only to the development of technologies related to the attraction of FDI. FDI can also have a negative impact on the country's balance of payments. Trade deficits can be a real obstacle for the economies of developing countries in the event that investors import more than they export. In this case, FDI can worsen the country's trade position. Inappropriate regulation of relations related to FDI can lead to instability associated with capital flows. Investments in physical assets are fixed, while the income received from them is variable. Therefore, these incomes can also be reinvested outside the country, and in many cases, they significantly exceed the amount of the initial investment over time.

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