CHAPTER SUMMARY

This chapter reviewed theories that attempt to explain the pattern of FDI between countries and to examine the influence of governments on firms' decisions to invest in foreign countries. The chapter made the following points:

1. Any theory seeking to explain FDI must explain why firms go to the trouble of acquiring or establishing operations abroad when the alternatives of exporting and licensing are available to them.
2. High transportation costs or tariffs imposed on imports help explain why many firms prefer FDI or licensing over exporting.
3. Firms often prefer FDI to licensing when (*a*) a firm has valuable know-how that cannot be adequately protected by a licensing contract, (*b*) a firm needs tight control over a foreign entity in order to maximize its market share and earnings in that country, and (*c*) a firm's skills and capabilities are not amenable to licensing.
4. Knickerbocker's theory suggests that much FDI is explained by imitative behavior by rival firms in an oligopolistic industry.
5. Dunning has argued that location-specific advantages are of considerable importance in explaining the nature and direction of FDI. According to Dunning, firms undertake FDI to exploit resource endowments or assets that are location specific.
6. Political ideology is an important determinant of government policy toward FDI. Ideology ranges from a radical stance that is hostile to FDI to a noninterventionist, free market stance. Between the two extremes is an approach best described as pragmatic nationalism.
7. Benefits of FDI to a host country arise from resource-transfer effects, employment effects, and balance-of-payments effects.
8. The costs of FDI to a host country include adverse effects on competition and balance of payments and a perceived loss of national sovereignty.
9. The benefits of FDI to the home (source) country include improvement in the balance of payments as a result of the inward flow of foreign earnings, positive employment effects when the foreign subsidiary creates demand for home-country exports, and benefits from a reverse resource-transfer effect. A reverse resource-transfer effect arises when the foreign subsidiary learns valuable skills abroad that can be transferred back to the home country.
10. The costs of FDI to the home country include adverse balance-of-payments effects that arise from the initial capital outflow and from the export substitution effects of FDI. Costs also arise when FDI exports jobs abroad.
11. Home countries can adopt policies designed to both encourage and restrict FDI. Host countries try to attract FDI by offering incentives, and try to restrict FDI by dictating ownership restraints and requiring that foreign MNEs meet specific performance requirements.

Critical Thinking and Discussion Questions

1. In 2008, inward FDI accounted for some 63.7 percent of gross fixed capital formation in Ireland, but only 4.1 percent in Japan (*gross fixed capital formation* refers to investments in fixed assets such as factories, warehouses, and retail stores). What do you think explains this difference in FDI inflows into the two countries?