

FOREIGN DIRECT INVESTMENT POLICY AS AN INSTRUMENT FOR SUSTAINABLE ECONOMIC GROWTH: A CASE OF IRELAND

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Abstract. It is scientifically proved that foreign direct investments (FDI) are one of the life-forces for economic growth. Foreign investors use local labour, capital, and natural resources that are constantly running out and limited. However, global companies that translocate their production process often devastate the nature of the host country. Decline of natural resources and climate changes forces to think about how people could develop country's economy and social welfare, but at the same time save nature and its resources. Global companies are the main developers of economy and social welfare, but also, they are environment polluters. The value of sustainable development is quite obvious, but there is a lack of research about the relationship between FDI and sustainable development in the literature. The literature separately analyses the problem of sustainable development or FDI impact on economic development. Often, FDI is described by determining the effects, but it does not address the question of expedient foreign capital, which would provide the greatest benefit to the host country. The article analyses the influence of foreign direct investments (FDI) on sustainable development. It develops the concept of sustainable investment. It aims to find out whether the purposively formed foreign direct investment policy can ensure the sustainability of economic development. In this case, FDI can become an instrument for the implementation of sustainable development. This study is about Ireland case. The choice is not coincidental. Since this country applied FDI policy, it was able to transform the economy rapidly, and also it became one of the most developed countries in Europe. The authors of the research chose ten economic, social, and environmental factors that define sustainable growth. The analysis revealed the contact between the indicators of FDI and sustainable growth in different periods of the economic cycle.

Keywords: Foreign direct investment, sustainability, FDI policy, Ireland, economic growth.

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1. Introduction

Industrialization and the scale of growing globalization determined vast use of natural resources. This problem became visible only at the end of 20th century, when production in all industrial countries started to destruct and devastate nature. Negative effects appeared in everyday of human life. Therefore,

this problem became more relevant, people started to ask how to combine economic growth, social welfare, without destroying the harmony of animate and inanimate nature. The harmony of these two areas is understood as sustainability (Beretta 2012).

In a broad sense, sustainable growth is understood as a compromise between environmental and social

goals of society, which provides possibilities to reach social welfare for the present and future generations within the permissible limits of environmental impact (National Sustainable Development Strategy of the Republic of Lithuania 2003).

Sustainable development is based on the general principles that are relevant to all nations. It helps to improve the quality of life for the present and future generations. Sustainable development helps to understand that the current lifestyle, globalization, and use of natural resources will influence the quality of the future generations. Sustainable world should ensure that human activities will not harm long-term productivity of ecosystems. Economics and society depend on nature, because it:

- Is natural resources necessary for energy production and services;
- During the process of production produces gases that causes greenhouse effect, and consumption waste devastates nature;
- Are resources necessary to create a comfortable human life, including stable climate and water.

Thus, scientific researches of sustainable development are naturally interdisciplinary; inevitably, they integrate different areas of life that reflects attitudes towards: social and economic development, technological advancement, environment protection, and changes in life of modern society (Melnikas 2010).

Since technologies are improving, the ambition of economic benefit with the help of reduced production costs is increasing, the companies were forced to translocate their production to less developed countries that have the advantage of cheap labour, i.e., to invest in a foreign country. Despite the fact that foreign direct investment is a catalyst for economic growth, in many cases, establishment of international companies and their development caused environmental problems. More and more often, sustainable development is recognized as a key to control the interdependence of economic and environmental protection. However, it is not a narrow concept or defined by a process, but it is a method, where:

- The use of resources;
- Deflection of investments;
- Focus on technological development;
- Institutional changes;

are combined with the current and future needs. Therefore, it involves difficult decisions that depend on political processes.

However, scientific literature lacks an analysis of connection between sustainable investment research and FDI and their points of connection. The authors' article about the problem of promoting foreign direct investment analyses FDI influence on the country's sustainable development.

The goal of article – to analyze the implications of applying purposefully formed FDI policy in sustainable economic development based on the example of Ireland. **The article uses** the analysis and synthesis of scientific literature, **methods** of statistical data and correlation-regression analysis.

2. Foreign direct investment impact on the development of a country

In the scholarly literature, foreign direct investment impact on the development of a country is controversial; therefore, it is very hard to evaluate the FDI benefits of living standards and sustainable economic growth in developing countries and countries that are in transition. Around 1953, the relevance of foreign capital has increased, because the task of capital structure decisions was to determine rational structure of the capital based on the chosen goal. Contemporary researchers (Morton 1954) actively analyzed the common foreign capital influence of financial support and foreign direct investments on the economic development of a country, but they determined only a negative FDI impact on country's economy, disadvantages of stability and reliability.

Moran (2005) distinguished two alternative concepts of FDI influence, based on which it is determined potential FDI impact on developing countries and countries in transition. The first concept provides a positive approach and notes that additional foreign investors increase the competition in the local market. The second one is not so optimistic. It emphasizes possible disturbing effects, when foreign investors can have imperfect internal market competitiveness from imperfect competitive market.

A positive approach defines foreign direct investments as an aid to developing countries and countries in transition in order to direct the development of economy towards development. It should be noted that since 1950, it was argued that foreign capital should flow from a developed country to developing country (Markusen 2013). In this case, the host country is understood as extremely poor country,

because it uses old production technologies, productivity level is low, so as a result the wages are also low (Eremina 2009). Low wages do not give an opportunity to the host country generate funds, therefore, it is impossible to create internal high level investments (Bora 2002). It suggests an assumption that developing countries and/or countries in transition do not have other options but to attract foreign capital. Hence, foreign direct investments supplement local funds by providing more effective management, marketing instruments, and technologies, thereby increasing the productivity of the country, which accepts the investments. However, national income depends on the flow of foreign capital and elasticity of capital demand (Dunning and Lundan 2009). In addition, local companies that take over new technologies and knowledge from MNCs, increase their productivity (Torrise *et al.* 2008; Tvaronavičienė *et al.* 2009; Miškinis 2010, Tvaronavičienė, Lankauskienė 2011) and become sufficiently competitive (Falla *et al.* 2009), increase production volumes through FDI (Moran 2005; Goose 2005), increase the level of productivity (Saggi 2009), and this is how the host country increase the rate of economic growth (Durham 2004; Ruane 2008). Reinvestments earned from companies that were acquired by foreign investors during privatization, increase FDI flows related to the initial investment. Finally, the programs of privatization indirectly enhance favourable FDI climate; for example, by instructing to fulfil government's obligations to execute the reforms in one or another public sector. During privatization raised FDI have a tendency to grow regularly (Nunnenkamp *et al.* 2007; Desai *et al.* 2004; Levi-Faur 2010). In this case, state's incentives to attract FDI are fully justifiable.

On the other hand, potential negative effect of foreign capital investment should be also taken into account. According to the followers of Dependencia School (Chase-Dunn 1975; Bornschier *et al.* 1978), benefit of FDI between foreign direct investor and the country, which accepts the investments, is inadequate, i.e., foreign investor exploits the country, which accepts the investments. According to the followers of Dependencia School, over time, a country, which stimulates FDI flows, becomes dependent on foreign investors, because MNCs are committed to invest in the country continually, reduce country's level of political activity, and it makes informal alliances with international companies. International

companies with the help of lobbying indirectly affect and stimulates the relationships between the governments in self-serving way. In subsequent literature, positive effect of MNCs skeptics (Pradhan 2008; Ruggaff 2008; Karabay 2010) note that the activity of foreign investors can have negative effect on the existing legal system and harm the process of decision-making at the highest level in the country. However, in order to attract foreign capital, it is rarely talked about possible negative effect on environment protection, i.e., industrial pollution impact on environment and health.

It is necessary to highlight FDI impact on the country and country's effect, because the movement of foreign capital is currently more intense. An investing company should have a certain, in fact monopolistic, advantage, which is achieved by using the disadvantages of the market. However, the question of foreign investment effect and intensive policy necessity in developing countries and countries in transition still remains.

It can be argued that FDI provides benefit and creates certain expenses as well as causes risks in the country, which accepts investments. The Governments seek to attract FDI and hope for a positive impact on economy, but FDI by them do not affect economy positively, because MNCs invest only if there is benefit for them. Thus, intensive FDI flows do not guarantee sustainable economic growth in the host country.

3. The concept of sustainable investment

Sustainable investment is a long-term investment, which is effective and fair to the present and future generations. The concept of sustainable investment promotes a long-term strategy of "in depth" and "in breadth" investments and this strategy should define investment goals and results for the current and future periods. A long-term strategy is focused on creating a value, which promotes the benefits in the near future without long-term period damage. Investments and economic support are provided not only to increase productivity of economic and ecological production, but also to reduce negative impact on environment and ensure human health. Narula (2012) distinguished three approaches to the concept of sustainable investment:

- Sustainable investment is based on economic, social, and environmental risk faced by the modern world. According to this approach, economic,

social, and environmental factors are systematically integrated into financial analysis in assessing the created value. An investment decision is made based on obtained results. It is important to promote sustainable development of various branches by using legal and economic instruments in the field of economics.

- Environmental, social, and institutional factors are used in the capital markets in assessing behaviour of companies and determining their financial activity in the future.
- Sustainable and responsible investing has five investment styles: ethical, responsible, economic, social, sustainable, and green technology investment.

There is no doubt that foreign investments are beneficial, because it positively affects economic environment, create new jobs, and transfer technologies. Lankauskienė and Tvaronavičienė (2012) claim that foreign direct investment influences not only economic growth, but also sustainable development. However, benefits depend on applied FDI policy in the country. Although FDI has a direct connection with economic growth, but connections with sustainable development are not clear and not sufficiently examined, especially, when it comes to environmental factors. Very often, researchers avoid conducting such studies due to political reasons. While executing strategic foreign investment project, the impact on environment is not significantly important, because economic and environmental compatibility increases project costs and payback time of investments. While executing investment projects, Dapkus (2008) suggests assessing the impact on the environment by taking into account the following aspects:

- The impact of small projects or management schemes that do not require the assessment of environmental impact according to the requirements;
- Possible occurring effects, when one project promotes the development of the other;
- Synergistic effect, when the impact of a few projects on the environment exceeds the total all projects' amount of environmental impact.
- Global effect, such as biodiversity and greenhouse gas emissions.

In case of strategic investment, the concept of sustainable development is irreparable in the countries occupied by bureaucracy, lobbying, and corruption.

The concept of sustainable development is also violated, when a country applies an active competitive policy regarding FDI and by all means seeks to attract foreign capital. In the context of controlling FDI if there are no boundaries and there is a liberal FDI policy, countries destroy themselves economically and environmentally. While negotiating on FDI, host countries reduce standards for MNCs behaviour, safety requirements, and environmental restrictions.

Kumar (2009) researches show that FDI has positive relationship with sustainable development indicators, in case when international sustainable development standards are actively applied in respect of foreign capital. He also recommends following the approach of sustainable and responsible investment. Also, it includes adding environmental, social, and institutional tasks to the policy of attracting FDI that would lead to consistent and long-term economic growth. Thus, in accordance with the principles of sustainable investment, created FDI policy becomes an instrument to implement the goals of sustainable development.

While analysing sustainability indicators, Čiegis and Zeleniūtė (2008) divides them into five categories: environmental protection, economic, social, and cultural. Eurostat system classifies sustainability indicators into ten categories:

- Socio-economic (economic development; innovations, competitiveness and eco-effectiveness; employment);
- Sustainable consumption and production indicators (resources and waste; consumption; products);
- Social dependence (education; labour market; poverty and living conditions)
- Demographic changes (life expectancy; inequality of retirement age income; sustainability of public finances);
- Public health (mortality rate; index of toxic substance products);
- Climate changes and energy consumption (climate changes; energy dependency);
- Sustainable transport (transport and mobility; vehicle effects);
- Natural resources (biodiversity; pure water resources; sea ecosystem; use of land);
- Global partnerships (trade globalization; funding of sustainable development implementation; management of global resources);

- Good management (compatibility and effectiveness; openness and participation; economic instruments).

Based on the classification of the indicators, the authors' article analyses the relationship of FDI in economic, social, and environmental indicator groups. Economic indicators include employment, GDP, which reflects the overall economic growth of the country, and which is measured in millions of Euros. The ratio of labour productivity was chosen, because it is one of the country's economic competitiveness factors. Social welfare indicators include population and migration that indirectly show the population's satisfaction with the current situation and income. In many countries, experience shows that deteriorating living conditions and declines of income forces people to migrate. Also, population rate determines the size of market and shows the change of population that is caused due to mortality and migration. The total energy consumption indicator was chosen in analyzing the relationship between MNCs activity and environment protection, because it is necessary for any industrial processes or services. The demand of energy services is determined by economic activity (Smaliukienė *et al.* 2012), therefore, the rate of gases that causes greenhouse effect is analysed as waste generated during the process of production. The relationship between energy consumption from renewable sources and FDI is analysed in order to check whether foreign capital promotes energy consumption from renewable sources. The authors seek to find out whether MNCs tend to invest sustainably. Provision of information and communication services shows country's tendency to "green" economy, i.e., whether it is focused on industrial sectors that pollute the environment or service sectors that do not require a lot of natural resources. Sustainable development is greatly influenced by the installation of advanced technologies in production. By introducing advanced technologies in production, it is possible to create effective production without increasing the impact on environment.

4. Case analysis

In 1920, Ireland understood that foreign trade and foreign investments will help to restore the economy and was the first, which started to form FDI policy. After the First World War, increased unemployment and migration to the United State forced the government of Ireland to take certain measures.

The first step was to move from strictly regulated regime, which was focused only on local business until 1920, to an open economy. In 1922-1932, foreigners were forbidden from establishing companies due to unstable politics and protectionism. Therefore, the policy of FDI promotion was stopped.

Only in 1949, Ireland established Irish Development Agency (IDA), which had the power to conduct both macro-economic and industrial policies. Since 1950, new companies of the country had to pay 10 percent income tax of profit obtained from export. Investments increased in the export-oriented sectors due to fiscal intensification.

Around 1970, Ireland started to conduct the second stage of FDI policy, and channelled FDI into production sectors. FDI supported not only new companies, but also the existing ones. Therefore, in order to develop local business and promote their relationships with foreign investors, clusters have been developed. While conducting the second stage of FDI, the dependency between FDI, GDP, and labour productivity started to become more visible (Table 1). During this period, the flows of foreign direct investments increased more than ten times (Fig.1), and also influenced consistent growth of productivity ($r=0,898$).

Although in the middle of eighties sectors of pharmaceutical and electronics were supported, there is almost no relationship between FDI and sustainable development indicators. This can be explained by the fact that this purposeful attraction of FDI caused delayed effects. This type of investments was attracted in 1989-1995.

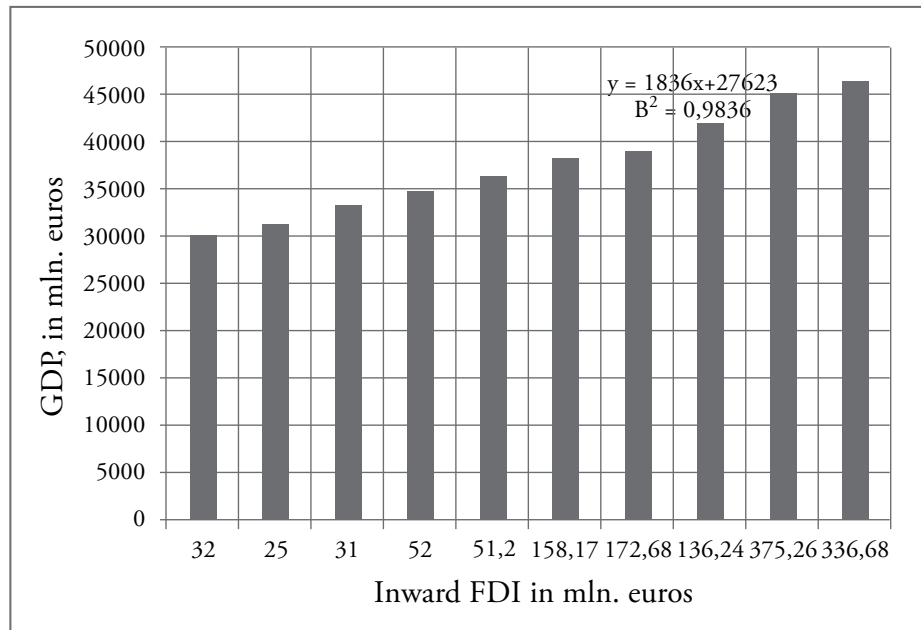


Fig.1. Relationship between GDP and inward FDI in 1970–1979

Source: UNCTAD

Ireland’s growth and transition from the periphery to the strong economic country took place only at the end of the nineties. During this period, strong and positive dependency of Ireland’s sustainable development indicators and FDI was emphasised. However, period of 1990-1999 does not show sustainable investment. Increasing productivity influences energy consumption ($r=0,886$) and emission of gas that causes greenhouse effect ($r=0,825$). Meanwhile, the relationship between FDI and energy consumption

from renewable sources was weak ($r=0,286$).

During this period, the relationship with GDP ($r=0,848$), foreign trade ($r=0,863$), employment ($r=0,886$) and FDI have significantly increased.

Murphy (2000) raises a question, how a country with slow economic growth, huge debts that in 1987 reached 125 percent GDP, high unemployment rate: 18 percent, and emigration became the country with almost full employment and high level of immigration.

Table 1. Results of correlation-regression analysis between variables characterizing sustainable development and FDI. (compiled by the authors)

	1970-1979	1980-1989	1990-1999	2000-2007	2000-2012	2008-2012
Productivity	0,898	0,028	0,742	-0,472	0,052	0,530
Population	0,889	-0,204	0,829	-0,463	-0,023	0,582
GDP	0,918	0,044	0,848	-0,461	-0,316	-0,907
Trade	N/A	0,270	0,863	-0,458	-0,303	-0,354
Employment	0,803	0,084	0,886	-0,455	-0,522	-0,755
Energy	N/A	N/A	0,894	-0,520	-0,504	-0,484
Migration	N/A	N/A	0,76	-0,124	-0,359	-0,875
GreenGas	N/A	N/A	0,825	-0,426	-0,397	-0,853
Electricity	N/A	N/A	0,286	-0,245	0,134	0,247
ICT	N/A	N/A	0,547	0,350	-0,029	-0,852
R	0,931	0,834	1,000	1,000	0,988	1,000
R square	0,867	0,695	1,000	1,000	0,975	1,000
F	12,995	2,853			13,207	

Dependent Variable FDI

Rios-Morales and Brennan (2009) explain that Irish success was a well-formed strategy of national economy, where in order to gain economic growth, there was an opportunity to exploit FDI and attract MNCs.

The model of Ireland’s internationalization defines two aspects (Bakker and Gulde 2010): developing favourable business climate for MNCs, especially in the sectors of high technology, when FDI policy is implemented in such way that FDI supply corresponds to demand, and the second aspect includes policies that would ensure the effectiveness of FDI and would operate as stimulating instrument of economy. It can be accomplished by determining long-term economic strategies linking them with the policies of different fields. This model, in particular, had to ensure the dynamism of FDI policy, its adaption to foreign capital demand, and create links between branches of global companies and local businesses.

However, the transformation of Ireland is not as

much important as the speed of transformation. Ireland distinguished 10 steps of transformation in FDI attraction strategy:

- Promotion of transforming the companies;
- Attracting new FDI forms;
- Development of regional economy;
- Establishing IDA agencies abroad and access online;
- Promoting openness to innovations;
- Promoting the attractiveness of Ireland’s offers;
- Cooperation with partners;
- Focus on creating high quality jobs in the service sector.

Murphy (2000) notes, that Ireland solved its problems by attracting foreign capital. The main investors were MNCs from USA and EU. From 2000 to 2004 FDI income were more than 100 percent of country’s GDP. However, FDI that were attracted during this period have only a weak reverse relationship with analysed indicators of sustainable development.

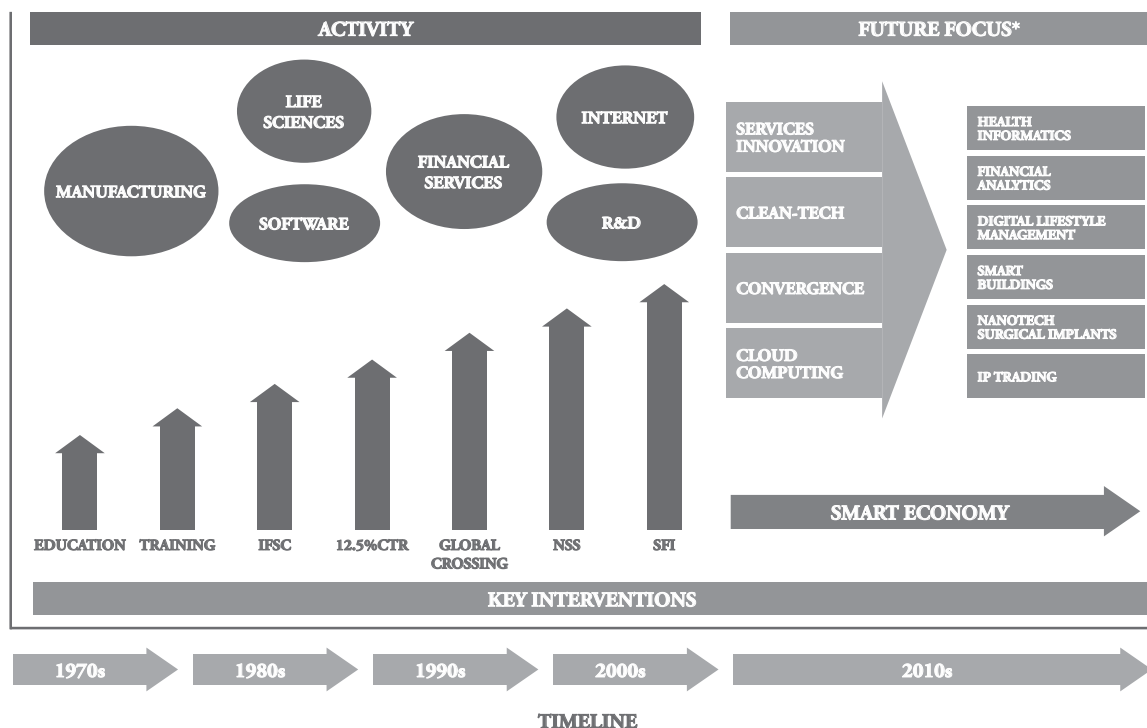


Fig.2. The history of FDI in Ireland

Source: IDA Ireland strategy – Horizon 2020

However, Kirby (2010) suggests that Ireland’s FDI policy is not too attractive, because the country itself has become extremely dependent on MNCs. In the early beginning of the global economic crisis in 2008, Ireland experienced strong consequences if the crisis (Fig. 3): during one year, economy has shrunk by

2.95%, and in 2009, by 6.91%. In 2009, the country was standing at the edge of bankruptcy. When the government returned to the regulatory policy, after three years of declining GDP, during 2011, Ireland’s economy grew by 1.4%, and in 2012, it grew even further by 0.4%. In the short-term, it is forecast that

there is a small, but strongly growing tendency.

During the critical period, almost all indicators of sustainable development have a reversed relationship with FDI. In 2009, energy consumption in all economy sectors has decreased, especially related to CO² emission. In 2010, during the downturn of economy, industrial energy consumption declined even more (Energy in Ireland 1990–2011). Strong and reversed relationship between FDI and GDP is observed

through the indicators of employment, migration, and gas that cause greenhouse effect as well as ICT that provide services. The latter relationship can be explained by the fact that a lot of foreign companies have worked in these particular sectors. However, at the beginning of the economic crisis, foreign capital companies were forced to move out of Ireland market or run off the revenue to the countries of their origin.

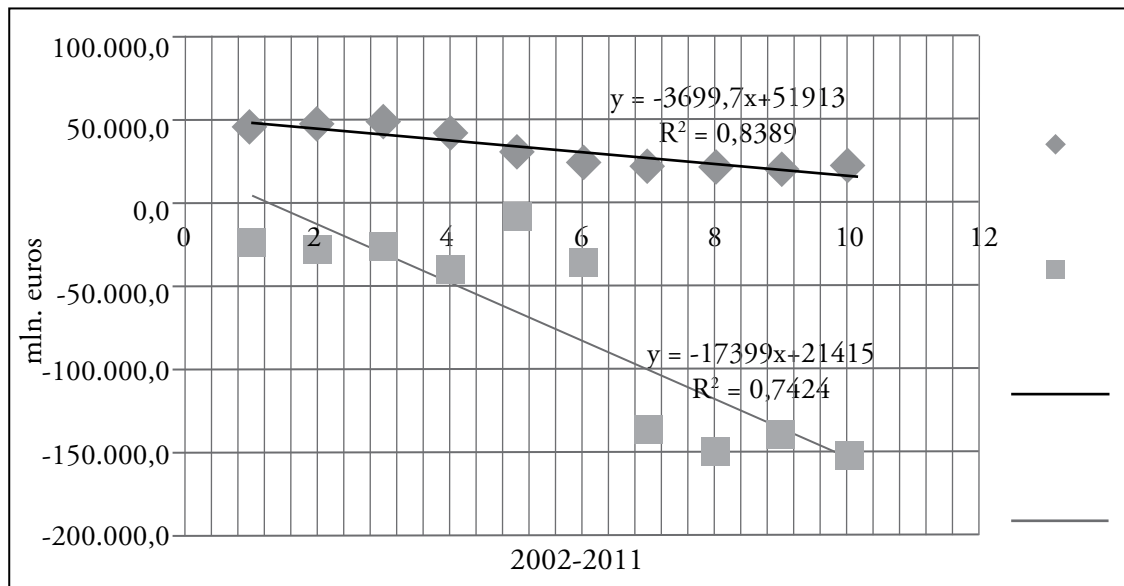


Fig. 3. Changes in Ireland's GDP and FDI rates in 2002–2011

Source: Eurostat

The run off of the capital has begun before the critical period – in 2007. Thus, after correlation-regression analysis, it was proved that FDI has a strong relationship only during the period of the “peak” or depressive economy.

Kirby (2010) identifies a number of problems due to which FDI policy of Ireland did not work during the crisis, even though the country created a policy, which was dynamic and responsive to the needs of market. Firstly, the level of country's regulation was too low: regulatory function was like given to the market participants.

Since 1997, Ireland's government associated FDI with financial services. This system was based on principles by which the banks and financial companies should follow the codes of conduct. Another problem, which caused the collapse of Ireland's economy, is the system of low taxes, which did not, left space for the government to control and manoeuvre during the crisis. Ireland is much more dependent on taxes

collected from goods and service export, rather than other EU countries. It is one of regressive tax system's features. Ireland sensitively reacted to the collapse of American corporations and withdrawal of foreign capital from the country, because the vast majority of investors were USA companies. The budget lost the main source of income: income tax of companies. The total percentage of Ireland's taxes, such as GDP / GNP, dropped to 39.6%.

Is it true that sharp and quick jump influences sudden drop? Ireland's failure was caused by two problems: failure to recognise international integration, very vulnerable sectors, and it attracted fierce criticism regarding the control of the government and inefficiency of Irish social partnership. The main business sectors of Ireland were dominated by MNCs, and FDI provided the basis for economic growth. At that time, it was thought that an intervention of economy would harm FDI attraction, and economic growth would decline.

It is obvious that in the presence of negative situation in the global arena, this statement was not proven. It may be concluded that while forming FDI promotion policy, it is necessary to integrate the instruments that would ensure consistent economic growth in the context of sustainable development.

Conclusions

Globalization, industrialization, and competition influenced companies' need to reduce the costs of moving the production to a country of cheap labour, where growth of production volumes increased the use of natural resources and waste generation as well as greenhouse effect gases. The problem of sustainable development was raised when companies started to use natural resources recklessly and choose "cheap" production technologies that pollute the environment. However, after analysis of scientific literature, it was noted that there is insufficient number of research about the initial "environment destroyer's" source, i.e., foreign investor and sustainable development. However, the literature defines the concept of sustainable investment, where FDI can be an instrument of implementing sustainable development. Empirical research showed that in separate economic cycles, the indicators of FDI and sustainable development can differ. The strongest relationship is visible only during the periods of peak and economic depression. Ireland's successful economic growth was influenced by purposefully formed FDI policy. The first implementation period showed strong relationship between FDI, GDP, and productivity. However, when the situation has changed, in 1980-1990, relationship between FDI and analysed indicators was almost gone. At that time, the country's debt was as high as 125 percent of GDP, and the rate of unemployment was 18%. After liberalization of FDI policy, Ireland's economy started to grow rapidly. At the same time, relationship between FDI and analysed indicators started to appear once again. Nevertheless, the growth of GDP and productivity increased energy consumption, but relationship between the indicator of energy consumption from renewable sources and FDI was very weak. It shows that investors, who invest in Ireland, do not tend to follow the principles of sustainable investment. Despite of Ireland's FDI policy disadvantages, the study showed that if FDI policy was integrated with the principles of sustainable investment, FDI could be an instrument for implementing sustainable development.

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