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Article

Conceptual Approaches to The Role of Foreign Direct Investment in The National Economy

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Abstract: The article examines conceptual approaches to the role of foreign direct investment in the development of the national economy. Foreign direct investment is interpreted not only as an external source of capital, but also as a mechanism for technological modernization, institutional transformation, integration into global value chains and improvement of national competitiveness. The paper analyzes classical, neoclassical, institutional, structural, dependency-based and modern strategic approaches to FDI. Particular attention is paid to the conditions under which foreign investment contributes to sustainable development, including human capital, macroeconomic stability, investment climate, technological absorptive capacity and quality of state regulation.

Keywords: Foreign Direct Investment, National Economy, Economic Development, Investment Policy, Multinational Enterprises, Technology Transfer, Institutional Approach, Global Value Chains, Economic Modernization

1. Introduction

Foreign direct investment occupies a central place in contemporary economic theory and development policy because it connects national economies with global capital, technology, managerial knowledge and international production networks. In its basic statistical meaning, FDI refers to a cross-border investment relationship in which an investor resident in one economy obtains a lasting interest and a significant degree of influence over an enterprise resident in another economy. International statistical standards usually associate such influence with direct or indirect ownership of at least 10 per cent of voting power [1]. This definition is important because it distinguishes FDI from short-term portfolio capital: direct investment is not limited to buying securities; it normally involves control, production decisions, long-term strategic presence and interaction with the host economy.

The significance of FDI has increased under conditions of globalization, technological change and the expansion of multinational enterprises. According to UNCTAD's World Investment Report 2025, global FDI flows reached about $1.5 trillion in 2024, but the headline increase was affected by volatile conduit flows; on a like-for-like basis, global FDI fell by 11 per cent for the second consecutive year [2]. This evidence demonstrates that FDI is sensitive to geopolitical tension, fragmentation of trade relations, financial instability and changes in industrial policy. Therefore, the role of FDI in the national economy cannot be studied only through the amount of inflows. It must be analyzed through the quality, sectoral structure, technological content, regional distribution and long-term development effects of investment [3].

2. Materials and Methods

The classical approach to foreign direct investment is associated with the theory of multinational enterprise and the explanation of why firms choose foreign production instead of ordinary export or licensing. Stephen Hymer's work marked an important turning point because he interpreted FDI not merely as an international movement of capital, but as a form of corporate control over foreign production [3]. From this perspective, the direct investor enters a foreign economy because it possesses firm-specific advantages: technology, brand, organizational knowledge, access to finance or managerial experience. FDI is therefore connected with market power and the capacity of multinational corporations to coordinate production across borders. For the host economy, such investment may bring modern technologies and managerial standards, but it may also increase the dominance of large foreign firms over domestic enterprises.

The neoclassical approach explains FDI mainly through differences in capital scarcity, rates of return and productivity. In economies where domestic savings are insufficient, foreign capital can fill the investment gap and expand productive capacity. Under this interpretation, FDI is beneficial because it increases gross fixed capital formation, supports employment, enlarges the tax base and creates additional output. However, this approach is limited when it reduces FDI to capital inflow alone. Direct investment differs from ordinary financial capital because it brings a package of assets: technology, production standards, logistics channels, export markets, corporate governance practices and specialized knowledge. Therefore, the neoclassical view is useful for explaining the capital-accumulation effect, but insufficient for understanding institutional and technological consequences.

3. Results and Discussion

A broader theoretical explanation is offered by John Dunning's eclectic paradigm, also known as the OLI framework. According to this approach, international production occurs when three groups of advantages are present: ownership advantages, location advantages and internalization advantages [4]. Ownership advantages belong to the multinational firm; location advantages are related to the host country's resources, market size, labour costs, infrastructure, institutions or strategic geography; internalization advantages explain why the firm prefers direct control instead of selling technology or signing contracts with local producers. For a national economy, this approach is important because it shows that attracting FDI depends not only on tax incentives, but also on the quality of location advantages. If the country offers only cheap labour or raw materials, FDI may remain concentrated in low-value activities. If it offers skilled labour, reliable institutions, transport infrastructure and innovation capacity, foreign investment may support deeper industrial upgrading.

The institutional approach considers FDI through the quality of the legal, administrative and regulatory environment. Investors evaluate not only market potential, but also property rights, contract enforcement, judicial independence, corruption risks, customs procedures, tax stability, currency convertibility and predictability of state policy. In this context, FDI is both an economic and institutional phenomenon. A country may have natural resources and a large domestic market, but weak institutions can increase transaction costs and reduce investor confidence. Conversely, transparent regulation and administrative efficiency may attract technologically advanced investors even in countries with smaller markets. Institutional theory also emphasizes that the developmental effect of FDI depends on the state's capacity to negotiate with multinational enterprises, monitor commitments, prevent harmful tax avoidance and encourage linkages with domestic firms.

The structural approach interprets FDI through its influence on the sectoral composition of the national economy. Investment may enter extractive industries, manufacturing, infrastructure, finance, telecommunications, agriculture, services or high-technology sectors. Each sector produces different effects. Resource-seeking FDI may increase export revenue but generate limited employment and weak technological spillovers if local processing remains underdeveloped. Market-seeking FDI may expand consumer choice and competition, but it can also displace domestic producers if they are technologically unprepared. Efficiency-seeking FDI, especially in manufacturing and export-oriented production, can integrate the country into global value chains and develop industrial skills. Strategic asset-seeking FDI is more typical of advanced economies, where firms acquire knowledge, patents, brands or research capacity. Therefore, the role of FDI in the national economy depends strongly on its structural orientation.

A key conceptual issue concerns technology transfer. Many economists argue that FDI can become a channel through which advanced technologies move from developed to developing economies. Borensztein, De Gregorio and Lee found that FDI contributes to economic growth more effectively when the host country has a sufficient level of human capital [5]. This conclusion has strong methodological importance: technology transfer is not automatic. Imported machinery, software or production standards generate sustainable growth only when local workers, engineers, managers and institutions are capable of absorbing, adapting and improving them. Without adequate human capital, FDI may remain technologically isolated inside foreign-owned enterprises, while domestic firms receive only limited spillover effects.

The modern global value chain approach expands the analysis of FDI beyond the national border. In contemporary production systems, one product may involve design in one country, components from several countries, assembly in another country and marketing through global platforms. The World Development Report 2020 notes that global value chains have played a major role in international trade and development, although technological change and geopolitical fragmentation can alter their dynamics [6]. Within this framework, FDI becomes a mechanism through which a national economy enters international production networks. The main question is no longer whether the country receives foreign capital, but what position it occupies in the value chain: raw material supplier, assembly base, component producer, logistics hub, design centre or innovation platform [7].

From the standpoint of national development, the most desirable form of FDI is not necessarily the largest inflow, but the investment that creates long-term productive capacity. Productive FDI contributes to industrial diversification, export sophistication, local supplier development, workforce training and technological upgrading. In contrast, speculative or weakly embedded investment may produce temporary financial inflows without deep development effects. This distinction is particularly relevant for economies that seek modernization. If FDI is concentrated only in real estate, retail trade or raw material extraction, its contribution to structural transformation remains limited. If it supports manufacturing, renewable energy, digital infrastructure, agro-processing, pharmaceuticals, machinery, education technology or research-intensive services, its developmental role becomes much stronger [8].

The dependency approach offers a critical interpretation of FDI. It argues that foreign capital may reproduce unequal relations between the centre and the periphery. Multinational enterprises may transfer profits abroad, dominate domestic markets, influence policy decisions, exploit natural resources or prevent the emergence of national industrial champions [9]. Although this approach is sometimes criticized for excessive pessimism, it raises important analytical questions. FDI must not be assessed only by inflow statistics; it is necessary to examine profit repatriation, tax payments, local procurement, employment quality, environmental standards, technology transfer and the degree of domestic participation. If foreign enterprises operate as isolated enclaves, their contribution to national development remains narrow. Therefore, a responsible investment policy must combine openness with national economic interests [10-12].

The developmental-state approach proposes a more active role for government. It does not reject FDI, but insists that foreign investment should be guided toward strategic sectors and connected with domestic development goals. Countries that successfully used FDI for industrial upgrading often applied selective policy instruments: special economic zones, local supplier programmes, export requirements, training obligations, research partnerships, technology parks and investment screening mechanisms [13]. The aim is not administrative restriction for its own sake, but strategic coordination between foreign capital and national priorities. Such an approach is especially important for developing economies because the market alone may direct FDI toward the most profitable sectors rather than toward sectors with the highest long-term social and technological value [14].

The macroeconomic dimension of FDI also requires careful assessment. Compared with short-term debt and portfolio flows, FDI is usually more stable and less vulnerable to sudden withdrawal. It can improve the balance of payments by financing investment, increasing exports and reducing import dependence when domestic production expands. At the same time, FDI may create future outflows through profit repatriation, royalty payments, intra-firm loans and imported intermediate goods [15].

4. Conclusion

Foreign direct investment is one of the most significant instruments connecting the national economy with global production, finance and technology. Conceptual approaches to FDI differ in their emphasis: the neoclassical approach stresses capital accumulation; the theory of multinational enterprise focuses on control and firm-specific advantages; the eclectic paradigm explains investment through ownership, location and internalization factors; the institutional approach highlights the role of legal and administrative quality; the structural approach examines sectoral transformation; the dependency approach warns against external domination; the developmental-state approach emphasizes strategic coordination between foreign capital and national priorities.

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