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NEW TRENDS IN THE DEVELOPMENT OF FOREIGN DIRECT INVESTMENT AND THEIR IMPACT ON THE ECONOMIC SECURITY OF THE HOST COUNTRY

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Abstract
This thesis analyzes the emerging trends in foreign direct investment (FDI), including digitalization, sustainability, geopolitical fragmentation, and regulatory tightening, and their multifaceted impact on the economic security of host countries. Drawing on widely cited empirical studies, it highlights both the positive effects—such as technology transfer, job creation, and infrastructure development—and the associated risks, including overdependence, national security threats, and environmental degradation. The paper recommends balanced FDI governance, institutional strengthening, and sustainable investment promotion as key policy priorities.

Keywords: Foreign direct investment (FDI), economic security, digitalization, green economy, national sovereignty, infrastructure, regulatory policy, emerging markets, risk mitigation.

Introduction

Foreign Direct Investment (FDI) has long been recognized as a pivotal driver of economic development, offering host countries access to capital, technology, and employment opportunities. Seminal studies have underscored the multifaceted impacts of FDI on economic security, particularly in the context of evolving global dynamics. For instance, Borensztein, De Gregorio, and Lee highlight that FDI can be a significant vehicle for technology transfer,

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contributing to economic growth, especially when the host country has a sufficient level of human capital [6. 115-135]. Similarly, Alfaro et al. emphasize the importance of local financial markets in realizing the growth benefits of FDI, suggesting that well-developed financial systems can enhance the positive effects of foreign investment [3. 89–112].

Li and Liu provide evidence of an increasingly endogenous relationship between FDI and economic growth, indicating that the two can mutually reinforce each other under certain conditions [17. 393-407]. However, the impact of FDI is not uniformly positive across all contexts. Iamsiraroj and Ulubaşoğlu conduct a comprehensive analysis and suggest that the FDI-growth relationship varies significantly depending on host country characteristics and the measurement approaches employed [13. 200-113].

Understanding these emerging trends is crucial for assessing their implications on the economic security of host nations. This thesis aims to explore the evolving patterns of FDI and their multifaceted impacts, providing insights into how host countries can navigate this complex landscape to foster sustainable economic growth and security. Moreover, the global FDI landscape is experiencing significant transformations influenced by geopolitical tensions and economic realignments. The International Monetary Fund (IMF) reports that emerging economies are disproportionately affected by the fragmentation of FDI flows, leading to potential long-term output losses of approximately 2% of global GDP. This underscores the critical need for host countries to adapt to these shifts to maintain economic stability and security [12. 103].

Additionally, the adoption of FDI screening mechanisms has surged, reflecting developed countries' policies aimed at restricting FDI on the grounds of broadly defined 'national security' interests. Uribe Teran explores how these mechanisms, if properly utilized, could also promote sustainable development and resilience, advancing climate action agendas [32. 6].

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Impact on Economic Security

Positive Effects:

- **Technology Transfer and Innovation:** FDI facilitates the introduction of advanced technologies and innovative practices, enhancing the productivity and competitiveness of domestic industries [6. 133]. According to Caves multinational enterprises (MNEs) play a crucial role in global technology diffusion by transferring knowledge and expertise to host economies [7. 27]. Loungani & Razin further argue that FDI promotes R&D spillovers, enabling local firms to upgrade their technological capabilities and enhance productivity growth [18. 6].
- **Employment Generation:** The establishment of foreign enterprises creates job opportunities, contributing to economic stability and growth [15. 74-94]. Blomström, Lipsey, & Zejan emphasize that FDI-driven employment is not limited to the formal sector; it also generates secondary employment effects through supply chain linkages and increased consumer demand [5. 269-276].
- **Infrastructure Development:** FDI often leads to the development of critical infrastructure, bolstering the overall economic framework of the host country [9. 588-589]. According to Barba Navaretti & Venables foreign investors contribute significantly to infrastructure projects, particularly in transportation and energy sectors, improving connectivity and economic efficiency [4. 182-183].
- **Market Expansion and Economic Diversification:** FDI introduces new business models and expands market opportunities for local companies. Alfaro highlights that sectoral allocation of FDI is crucial for economic growth, as investments in manufacturing and services promote diversification and reduce economic volatility [2. 13-14]. Li & Liu argue that the relationship between FDI and economic growth is increasingly endogenous, meaning that countries with strong institutions and policies can maximize FDI's benefits by fostering local business expansion [17. 393-407].
- **Increased Tax Revenue and Government Funding:** Foreign investments contribute to tax revenues, which governments can use to finance public services, social programs, and infrastructure projects [23. 4]. Nunnenkamp & Spatz emphasize that the fiscal impact of FDI depends on host-

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country policies, particularly regarding taxation and profit repatriation regulations [19. 53-136].

Potential Risks:

- **Dependence on Foreign Capital:** Over-reliance on FDI can make economies vulnerable to external shocks and the strategic decisions of multinational corporations [25.365-412]. Rugman argues that MNEs exert substantial control over global capital flows, meaning host countries with weak economic structures may struggle to mitigate the risks associated with sudden capital withdrawals [26. 49-60].
- **Erosion of Domestic Industries:** Intense competition from foreign firms may challenge local businesses, potentially leading to their decline [1. 605-618] According to Caves while MNEs enhance productivity through competition, they can also crowd out domestic firms that lack access to advanced technologies and financial resources [7. 2-19]
- **National Security Concerns:** Investments in sensitive sectors may pose risks to national security, necessitating careful scrutiny and regulation [16. 2]. Figure 1 presents the index of restrictiveness of direct investment regulation.

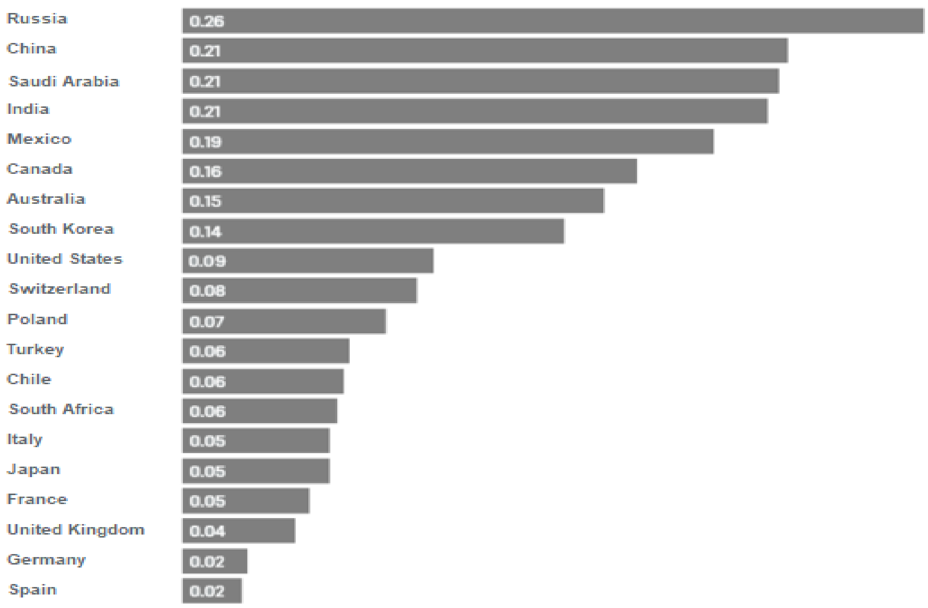

Figure 1. FDI regulatory restrictiveness index, 2020 *(selected countries)*.

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Note: A score of 1.0 indicates an economy closed to foreign investment, while a score of 0.0 indicates an open economy.
Source: Organization for Economic Cooperation and Development.

Loungani & Razin caution that foreign control over critical industries, such as telecommunications and energy, can expose host economies to geopolitical vulnerabilities and economic coercion [18. 8].

- **Profit Repatriation and Limited Local Benefits:** While FDI brings capital inflows, a significant portion of profits generated by foreign companies is often repatriated to their home countries [29. 4]. Nunnenkamp & Spatz note that repatriation patterns vary by industry and firm strategy, meaning host countries must implement policies to maximize local reinvestment of FDI earnings [29. 4].
- **Environmental and Social Concerns:** There is a proportional relationship between FDI inflows and CO_2 emissions, contributing to environmental degradation. This means that companies seek refuge in host countries to relocate their polluting plants in the face of weak environmental regulations [35. 195].

The 2015 Paris Agreement on reducing global warming requires its members to implement nationally determined programmes to contribute to the 1.5°C target [24. 1]. Countries can transfer production processes that affect local climate change to other countries through foreign direct investment.

Foreign companies often refuse to meet economic requirements by exploiting natural resources, diverting funds to environmentally hazardous production, using partners' territories for the processing and disposal of harmful, toxic waste, and using technologies that are banned in developed countries due to their high environmental impact.

- **Transfer Pricing Issues of Multinational Corporations (MNCs):** The transfer pricing system within transnational companies reduces the balance sheet income indicators and leads to a decrease in funds directed to the economy of the country where the branch of transnational companies operates and the redistribution of the income received to the country where the headquarters of transnational companies are located.

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According to research by UNCTAD and other international institutions, 80% of the world's value added is formed within the framework of production and trade chains coordinated by transnational companies [27. 22-23; 33. 201]. Also, 60% of trade is made up of spare parts and components used at various stages of production. In this case, transnational companies conduct their own special internal pricing policies, the basis of which is the task of reducing the taxable base, as well as the income indicators. This is facilitated by a system of reducing the prices of intermediate components, the production of which in some countries is even unprofitable (unjustifiable). However, the prices of finished products sold in other countries compensate for these losses. It is very difficult to resist the export of a significant part of national wealth by transnational companies through the internal transfer pricing system. As a result, the state does not collect taxes, and the money "serves" the economy of another state.

• **Anti-competitiveness and maintenance of monopoly.** TNCs may increase their lobbying efforts if they are focused on serving domestic markets protected by high tariffs or non-tariff barriers. Domestic competition may also be lost as a result of the acquisition of a domestic company by a TNC, which may lead to the consolidation of domestic producers due to mergers or other corporate failures [18. 8]

Conclusion and Recommendations

To harness the benefits of FDI while safeguarding economic security, host countries should:

- **Implement Balanced Policies:** Establish frameworks that attract FDI in sectors aligned with national development goals and security considerations [28. 25].
- **Promote Sustainable Investments:** Encourage FDI in green and digital technologies to foster long-term, sustainable economic growth [22. 69]. The FDI Qualities Policy Toolkit developed by OECD reviews policy practices to improve the impacts of foreign direct investment (FDI) on sustainable development. It focuses on four areas of the Sustainable Development Goals (SDGs):productivity and innovation, job quality and skills, gender equality and decarbonisation. Each chapter describes how to assess the impacts of FDI and

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provides policy recommendations related to governance, domestic and international regulation, financial and technical support, and information and facilitation services.

- **Non-discrimination** – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security. **Transparency/Predictability** – while it is in investors' and governments' interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes. **Regulatory Proportionality** – restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern. **Accountability** – procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels should be considered to ensure accountability of the implementing authorities [20. 5].
- **Enhance Domestic Capabilities:** Invest in education and infrastructure to improve the competitiveness of local industries, enabling them to benefit from and collaborate with foreign enterprises [10. 761-763].
- **Strengthen Regulatory Mechanisms:** Develop transparent and efficient FDI screening processes to protect national interests without deterring beneficial investments [8. 5]. Developing transparent and effective foreign direct investment screening processes is essential to protecting national interests and encouraging beneficial investment. The Council on Foreign Relations (CFR), a US-based think tank, has discussed the importance of balancing national security concerns with economic openness in foreign direct investment policy. For example, the Council's report "Foreign Investment and National Security" examines the trade-offs between foreign investment and national security and

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emphasizes the need for a process that minimizes security risks without deterring future investment.

By strategically managing FDI inflows, host countries can leverage foreign investments to bolster economic development while ensuring their economic security remains intact.

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