Foreign direct investment as an alternative for infrastructure building in Latin America

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Abstract - In this research we study the FDI impact on infrastructure and propose how governments from Latin American countries can improve the effects that this investment has in home infrastructure.

Introduction

The foreign direct investment (FDI) is understood as the Multinational Enterprises (MNE) mechanism of expansion abroad and the mechanism to enter overseas countries. During the last decades the empirical study of the inward foreign direct investment has shown its impact on host countries, in particular in those countries with less economic development, the emerging countries. The FDI issued by a MNE could have direct as well as indirect effects on the host countries. The effect on Infrastructure is considered as a direct effect.

The subject of infrastructure related with the foreign direct investment has been studied in two different ways. In the first one, infrastructure is seen as a driver for MNE allocation. In the second one, the infrastructure is seen as part of the positive impacts that inward FDI has on home countries. Nevertheless this latest approach has not been broadly studied, yet during recent times the understanding of this phenomena has been taking more relevance (Donaubauer, Meyer, & Nunnenkamp, 2016; Germaschewski, Forthcoming; Sawant, 2010).

In this research we focus on this last perspective, when MNE address their investments to host economies and how they contribute to the host country infrastructure development; in general in emerging economies but particularly in Latin American countries. It is also discussed which role the government has in the promotion and how it contributes to the domestic infrastructure improvement through foreign private capitals.

Multinational enterprises and host country infrastructure

The FDI and the impact that it has in developing and developed countries has been broadly studied. In the case of developing economies, in theoretical and empirical terms inward FDI brings direct and indirect benefits to the host country. This investment is considered as an external source of capitals and can contribute to the gross capital formation in the host economy, it can improve the transfer of technology and some other spillovers (Cheng & Yan, 2003) like new jobs, management and marketing skills, improvement of productivity and competitiveness that can lead to the economic growth of the host economy.

Infrastructure is an important part to focus on when talking about inward FDI. And given the lack of resources in emerging economies and making particular reference to those from Latin America in comparison with developed countries and also other Asian emerging economies, the topic becomes relevant. Even more given the role that infrastructure development has on economic growth. Actually there is empirical evidence that clearly has identified the straight impact that infrastructure has on economic development in other emerging economies like China or India (Sahoo & Dash, 2009).

In this regard, public and private investment for infrastructure development results highly relevant. Foreign direct investment contributes to offset and in a certain extent to overcome the lacks that home governments have related to infrastructure. And here lies the role of the FDI as an alternative to the infrastructure improvement in the Latin American countries. Foreign multinational enterprises can bring to these countries infrastructure services such as transport facilities, telecommunications, water and waste treatment, electricity, airport terminals, roads, railways, to name a few. Frequently governments from Latin American countries do not have enough budget to spend in such infrastructures and often they are inefficient (Sader, 2000).

During the 90s, Latin American countries received considerable amounts of FDI addressed to infrastructure related with public good services. These foreign capitals where mainly due to privatizations that were a common practice

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during the period (Sader, 2000). Multinational enterprises have entered to this region in various ways like greenfield, mergers and acquisitions and joint ventures. However, greenfields have not been a highly popular entry mode in comparison to mergers and acquisitions. This fact restricts to an extent the positive direct effects that foreign capitals could bring to the countries since greenfield investments have better overcomes than merger and acquisitions (Wang & Wong, 2009).

The challenge is to maintain and improve the inward investment trends that got into Latin American countries during the 90s and furthermore keep it sustainable. Nevertheless this is not an easy task, when, generally speaking, emerging economies have weaker institutions and a politically unstable milieu, situations which are reflected in riskier transactions for multinational enterprises, in comparison with developed countries. Even more when industry risk is higher for infrastructure than in manufactures (Ramamurti & Doh, 2004).

Home governments and infrastructure development

The participation of the home government is fundamental regarding the FDI. It can make the national conditions both tangible and intangible for the attraction of foreign capitals but it can also increase the positive effects of those investments in the host economy. In this section we are going to check how the host government can contribute to the improvement of national infrastructure in Latin American countries by means of FDI. Furthermore it is possible that domestic investment abroad, or outward FDI, could contribute to the national infrastructure development, and in this second case, the home government is likewise essential.

One first step in this issue is that host governments create, develop and provide the conditions to promote the entrance of capitals from foreign enterprises (United Nations, 2003). It has to do with the liberalization process that most Latin American countries have conducted, stable policy frameworks, institutions, trade openness and generally speaking certainty to foreign firms to perform in the host country. Governments also have to address investments in order to improve their endowments since these investments are going to increase the attraction of Multinational firms (Donaubauer et al., 2016) either in terms of number of enterprises but also in amount of money.

The above constitutes the general conditions for the attraction of FDI. That is to say, those elements are key points for foreign firms' allocation. A second way to attract FDI is through the investment promotion agencies that all countries in Latin America have. These investment promotion agencies can develop special plans and programs specifically oriented to attract investments to provide infrastructure to the recipient countries, particularly the infrastructure that the country lacks.

It is important that host governments make sure that foreign investments will produce benefits. This is relevant because there is also evidence pointing out that inward FDI is not always going to have positive effects (Kimura & Todo, 2010). In this sense, on the one hand, the selection of the accurate investment is going to play a fundamental role as well as government controls. On the other hand, and following the same line of the investment promotion agencies, these institutions give several incentives for the attraction of foreign enterprises, which by and large don't ask for any requirement to the MNE. The proposal here for Latin American countries is to condition the incentives that the country gives in return for the improvement of the host country's infrastructure. Furthermore, this last scheme could works either for investments dealing with infrastructure activities or investments for any other sector.

Another way how governments can promote infrastructure development relates to the promotion of the expansion of national enterprises through direct investment abroad. As the mechanism is the same this is, to some extent, similar to the previous case. The government can develop a framework along with home country measures to promote the internationalization of its own enterprises. The government can state the infrastructure as a strategic sector and in consequence it is going to provide support to those enterprises with direct positive effects in the home economy, including the remaining of the current activities instead of their relocation to other countries.

Home country measures for the promotion of national enterprises abroad is not new. Both developed and developing economies have been promoting domestic firms' expansions. In the case of Latin American countries, only Brazil, Chile and Mexico have some measures for that purpose. Perhaps it is not as popular as the programs for the attraction of FDI because the impacts to the country are not so clear and straightforward (Economou & Sauvant, 2013). However, the participation of the local institutions is fundamental to control and to make sure that potential benefits will have the expected effects, in this particular case, in the improvement of the infrastructure for the country.

There is one last proposal to improve infrastructure in the host economy through FDI. Given the financial lacks that countries from Latin American have, it has to do with mixed capitals. This mechanism is thought to solve the infrastructure problem with FDI through a joint public-private partnership with domestic private firms (Germaschewski, Forthcoming). This is a new instrument to finance infrastructure in low-income economies, however, it could be helpful for emerging economies as well and specifically for countries from Latin America.

Conclusion and challenges for the future

The inward FDI in emerging economies has resulted in positive effects on economic growth. In the case of the impact of the FDI on infrastructure the situation is similar. That is to say, foreign private capitals contribute to the improvement of infrastructure that emerging economies need due to their lack of resources. Latin American countries could improve their own conditions in terms of infrastructure considering for this aim inward FDI. This is more relevant when the development of infrastructure promotes the economic development in the host country.

In this research we have shown some ways in which governments from Latin American countries can improve the development of infrastructure through inward FDI but also with domestic direct investment abroad. More important is the role that governments play in making sure that the potential benefits for the country created by the multinational enterprises, foreign and domestic, are actually realized. Here a virtuous circle takes place: the better the host country's international conditions the more FDI it will receive. This inward FDI will improve the host country's infrastructure which will impact on its economic development, which, at the same time, becomes a driver for more foreign capitals allocation.

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