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FOREIGN DIRECT INVESTMENT (FDI): CASE OF AFGHANISTAN

Habib Ahmad Karimi

Kabul University

Abstract

Foreign Direct Investment is one of the vital parts of the Global Economy. In the past, countries were trading, and they were sending their goods and raw materials to each other, so with this procedure, they were gaining their needs and profit. I mean in the past; people were exchanging goods. After that, the idea of Foreign Direct Investment (FDI) came to the global economy, and with this new practice multinational companies were transferring labor, capital, technology, equipment along with skills and knowledge to other countries, so using from FDI, multinational and joint stock companies with chain of firms gained huge profit from the world economy. Also, those countries which were not able to utilize their resources (host countries), gained enough experience and knowledge plus profit from FDIs. In this paper I am going to explain FDI along with a case in Afghanistan which failed and caused millions of US dollar loss to economy of Afghanistan.

Keyword: Investment, Profit, Opportunity, Economy, Corruption, Trade, Transnational Corporations

1.INTRODUCTION

Investment is one of the essential parts of the world economy. Through Investment, firms and companies gain enough profit and skill from the global economy. Advantages of investment (either in home country or Foreign Direct Investment) are as follows:

1- Investment builds wealth
2- Investment provides job opportunities and income, so investment affects aggregate demand and aggregate supply in the economy.
3- Investment decreases negative social impacts of unemployment.
4- Investment causes growth to other small enterprises.
5- Investment provides economic growth and development to a country.

Also, there are other minor benefits of Investment. Now I want to define an investor. An investor is, whom detects opportunities and after enough cost-benefit analysis[1], invests on a certain project with a particular level of risk.

I should state that Afghanistan is a during develop country with a short pace. Our big investments are in mining sector, and Afghanistan has not improved enough to invest on other sectors of the economy. There are different reasons behind this:

1- Insecurity or unstable security which is one of the big problems that causes investors to carry their investments abroad.
2- Illegal competition in which different companies use from illegal ways to expel their competitors from the market. Damping and speculation are common in Afghanistan especially in food industry.
3- Corruption which is the worst case for new investors.
4- Price instability: Every week, Central Bank of Afghanistan sells US dollar through an operation which names Auction of Dollar, and this action stabilizes the prices nominally.

[1] Cost-benefit analysis explains the cost of a project plus the benefits that the certain project will produce. If the costs of a certain project is higher than its benefit, the project will be cancelled, and vice versa if the benefit of a project would be higher than the costs, the project would be considered as beneficial.

5- Afghanistan does not have enough well-developed infrastructure. There are cases that some multinational companies wanted to invest on Ash mines of Afghanistan which are placed on north, but they ignored after analysis of Economic Infrastructures like roads and streets. Moreover, there are other minor reasons that I do not want to delve deeper on.

2. WHAT IS FOREIGN DIRECT INVESTMENT?

In the early 1990s, cross-border capital flows rose sharply. Their composition also changed in meaningful ways. An increasing share of flows directed towards developing countries (Calvo, 1996) largely took the form of Foreign Direct Investment (FDI) rather than portfolio or equity flows. Following the sharp decline in capital flows worldwide precipitated by global crisis of 2007-2008. FDI flows to developing countries rebounded more quickly than other components of global capital flows (Duttagupta, 2012) and remain high, at roughly 10 percent of gross fixed capital formation.
As I told before, Foreign Direct Investment is one of the crucial parts of the global economy. Foreign Direct Investment is when an investor directly invests in a host country, and the mentioned investor, directly carries his home country technology, capital and skill to the target country.
Moreover, most of the Foreign Direct Investments is operated by multinational or transnational corporations. Multinational corporations[2] are transplanters of Technology, labor, capital and skill, and the mentioned corporations have easy access to global markets. (Ozawa, 2016)

2.1. Types of Foreign Direct Investment

Greenfield Investments:

is one of the most welcomed Foreign Direct Investments. In a Greenfield Investment, foreign companies establish new production capacities in the host country. Greenfield Investment is most welcomed by during develop countries when there are high rates of unemployment. This means that Greenfield Investments create new jobs and increase productivity. (Zeqiri, Bajrami, 2016)

As I explained Greenfield Investment briefly, I should state that Greenfield Investment[3] is one of the vital investments for during develop countries. During develop countries can't utilize their resources effectively and efficiently, and they need a giant transnational corporation with enough level of experience to invest and utilize their resources. In Greenfield Investments, when investors want to invest in a host country, they carry their skills and capital along with technology to the host country, and with this procedure, host country unemployment rate decreases, and new jobs are created by Foreign Direct Investment. Also, domestic workers can learn skills of Foreign Direct Investors and this will lead to prosperity of host country industries because trained human resources are so important which will maximize profit of an industry and minimize costs. I should note one more thing that Economic Scholars might say that, domestic companies might loss their profit when a Foreign Direct Investment comes, but when a Foreign Direct Investment comes to a country, it increases knowledge and skills of domestic workers which will be beneficial for future of domestic companies. Also, high wages and high rates of employment will increase demand which will increase supply of domestic firms. Moreover, FDI needs raw materials or other factors of production which domestic firms could provide.

Mergers and acquisitions:

mergers and acquisitions usually are undertaken when a transfer of existing assets from local firms to foreign firms takes place. In other words, assets and operation of firms from different countries are combined to establish a new legal entity. When businesses and their assets are combined or consolidated, mergers and acquisitions take place. (Zeqiri, Bajrami, 2016)
Now that we understood mergers and acquisitions briefly, I should delve deeper on difference and advantages and drawbacks of mergers and acquisitions.

[2] Multinational Corporations operate in more than one country.

[3] Greenfield Investment carries higher risk and costs.

Acquisition is when one company purchases another company. Merger is when two companies join, and move forward as a new single entity.

Advantages of mergers and acquisitions are as follows:

1- Product diversification and expanding market reach: When companies join forces, they develop and expand new products, enter new geographic regions with new opportunities, and target customers.
2- Economies of scale: combination of resources and capabilities of multiple companies can lead to economies of scale which will save cost, improve efficiency and enhance quality.
3- Access to new Technologies and Innovation.
4- Competitive edge Improvement: When companies join together, they can gain a dominant position in the market which will increase their competitive edge. (Nguyen, 2024)

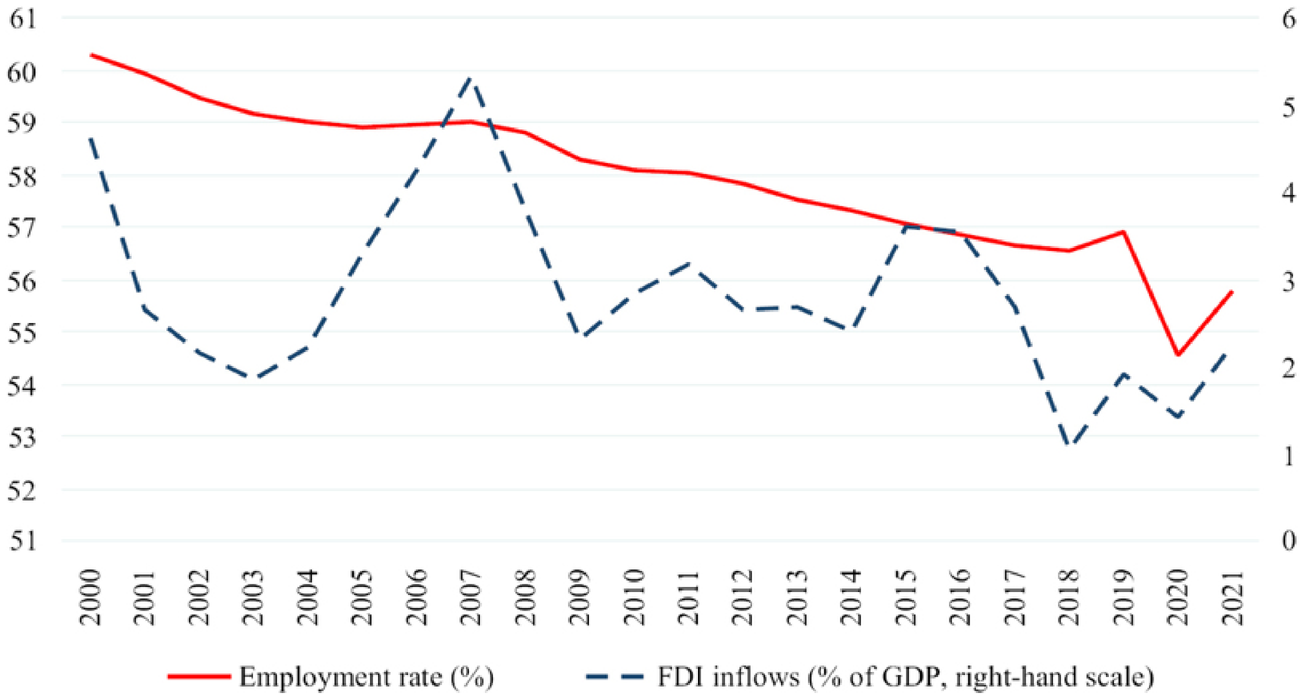
Disadvantages of mergers and aquations are as follows:

1- Potential for culture clash and management issues: conflicts and tensions between the merging companies due to differences in corporate culture, values and vision could be created by mergers and acquisitions.
2- Regulatory hurdles and antitrust issues: legal complexities and regulatory hurdles might prevent completion of mergers and acquisitions.
3- Financial risks and unexpected costs.
4- Employee Turnover. (Nguyen, 2024)

Joint Venture: Joint Venture can involve a local company, government or a foreign company operating in the host country. According to the model of Casson (2000), formation of joint ventures has nine factors such as: economies of scale, market size, economies of scope, technological uncertainty, technological change, cultural difference, interest rates, protection of autonomy, and missing patent rights. (Casson, 2000)
I should state that like other investments, joint ventures have advantages and drawbacks. Although, advantages of joint ventures are new insights, shared costs and expanded networks, its drawbacks are cultural clashes and unequal involvement.

2.2. Effects of Foreign Direct Investment (FDI) on Employment

First of all, I should state that usually FDI is in the form of creation of new plants (greenfield investment), or changes in the ownership of existing assets (financial investments). I analyzed greenfield investment before, but for financial investment I should assert that in financial investment ownership changes, and the existing facilities alters, expands or enhances after it is acquired by new investor. (Foreign Direct Investment in Latin America and the Caribbean, 2013)
Greenfield investment has a positive impact on employment, and this sort of investment is most welcomed by during develop countries. As greenfield investment is physical investment, it reduces unemployment. Both physical investment and financial investment can have negative impacts on employment. Jobs might be destroyed because of modernization process. Also, uncompetitive domestic firms might leave the market because of weak competitive ability. In order to delve deeper on the negative effects of physical and financial investments on employment, I should state that when labor-saving technologies are introduced in the market, unemployment rate would increase.
Studies on the relationship between FDI flows and labor-market dynamics usually differentiate between these two types of investment. Investment promotion agencies such as Invest in France Agency (IFA) generally focus their reports on physical investment projects, which are more relevant to employment. (Foreign Direct Investment in Latin America and the Caribbean, 2013)
Ernst, Berg and Auer (2007) produced a landmark research study in this area. It was designed to analyze the impact of FDI on employment during the period 1990-2004, especially in the three biggest countries in Latin America (Argentina, Brazil and Mexico). The authors observed that the substantial inflow of FDI had negative impacts on employment, largely owing to the characteristics of the FDI received.
The following graph indicates effect of Foreign Direct Investment on host countries employment from 2000 to 2021.



Source: Russian Journal of Economics

3.CASE OF AFGHANISTAN

Afghanistan is a during develop country with lots of valuable natural resources. Its total resources value is equal to 3 trillion US dollar. Afghanistan needs Foreign Direct Investments in order to extract and utilize its natural resources and use them for prosperity of that respective country because Afghanistan is not well-developed, and its economic infrastructure is weak. Also, government of Afghanistan is not able to utilize its resources efficiently and effectively because of capital shortage and different other minor and major reasons. FDI helps our country to utilize its natural resources and accelerate economic growth and economic development. In this paper, I am going to provide enough details of a failed FDI and the reasons behind that. I am sure that the mentioned case would help Foreign Direct Investors to better analyze a host country, and make their project successful.

3.2. The Project of Aynak Copper

Aynak copper is one of the biggest copper mines in the world which is located at Logar province with total value of 3.5 billion US dollar, and this is one of the Giant Foreign Direct Investment in Afghanistan. MCC was the name of a Chinese governmental company which qualified for Aynak copper project in 2007 with total value of 3.5 US dollar. The mentioned company estimated total value of the copper in the mine to 10 billion US dollar. Moreover, in this project Chinese Company would pay 808 million US dollar as mine royalty, and the mentioned company would build Railway along with 400-Megawatt electric generation machine. Additionally, this project would create 3000-4000 job for the resident of the mine.

3.3. Reasons Behind Project Failure

There are several reasons behind failure of Aynak copper project which are as follows:

1- Insecurity: is one of the big problems for every investment. Insecurity was the primary cause of failure of the project. Even some of Afghan and Chinese economists and high-level authorities said that insecurity caused to the failure of one of the big projects that could have a positive effect on growth and development of Afghanistan. During 5 years after signing of the contract, 1 gram of copper was not extracted because of insecurity.

2- Incomplete Evaluation: is the second important cause of failure of the project. MCC company did evaluate the region completely, so when they signed the contract Buddhist historical elements and monuments were found in the mine and resulted to project failure.
3- Incomplete Cost-Benefit Analysis: also cooperated to the failure of the project. MCC company did not analyze costs and benefits of the project, and after signing of the contract, the mentioned company was not eager to continue the project.
4- Third party intervention: As Taliban occupied some part of Afghanistan, they were much dangerous to the result of the project. Also, they wanted to gain some from the project in which MCC company and Afghanistan government were not eager to share the project with them.
5- Corruption: from 2002 till signing of Aynak contract with MCC, almost all of the contracts were shared with public, but contract with MCC never was shared with public because of corruption. Also, ministry of mine did not announce the project of Aynak copper. According to procurement law of Afghanistan, every project should be announced and after enough evaluation, the project should be given to the winner of the bidding, but the contract signed between both parties secretly.
6- Intervention of some high-level governmental authorities also cooperated to the failure of the project. Base to published documents, Mahmood Karzai brother of Hamid Karzai had a large effect on the mentioned project.

4.BRIEF CONCLUDING REMARKS

Foreign Direct Investment is one of important aspects of global economy. There are developed and developing countries all over the world, and some developing countries can't utilize their natural resources because of capital shortage, so they need FDI of developed countries. FDI would utilize their resources, and during develop countries can accelerate their economic growth and economic development through using and allocating the resources that they gain by FDI. Unfortunately, because of several reasons Afghanistan government was not able to utilize its copper resources which harmed our economy, and we lost the opportunity, so whenever a Foreign Direct Invertors want to invest in a host country, they should consider different aspects in order to achieve a successful investment.

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