Chapter 12
Outward US Foreign Direct Investment and Environmental Degradation

João Bento
https://orcid.org/0000-0002-1145-9664
University of Aveiro, Portugal

Miguel Torres
University of Leeds, UK

Paolo Maranzano
https://orcid.org/0000-0002-9228-2759
University of Milano-Bicocca, Italy

ABSTRACT

This chapter analyzes whether US outward foreign direct investment contributes to mitigating environmental degradation in host countries or not. This relationship is investigated within the environmental Kuznets curve framework, using dynamic panel data models which include trade openness and environmental regulation as controlling variables. The results lend support to the existence of an environmental Kuznets curve hypothesis. Moreover, the results indicate that capital expenditures from majority-owned foreign affiliates of US multinationals decrease carbon dioxide emissions per capita and provide support for the pollution halo hypothesis. The findings suggest that foreign direct investments carried out by firms with their headquarters based in the United States of America enhance the natural environment. These findings offer some support for host government policies offering generous financial incentives to attract environmentally friendly investments to improve environmental sustainability.

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INTRODUCTION

There is worldwide concern that climate change presents serious risks with the potential to impact human activities (Stern & Stern, 2015). Many countries are collectively taking action to reduce global pollutant emissions and implement an adequate set of incentives to support green technology investments.

Foreign direct investment (hereafter FDI) by firms with their headquarters based in the United States of America accounts for a large share of global FDI (United Nations Conference on Trade and Development, 2018). The United States is the largest trading and investment partner for almost all other countries in the global economy, providing important sources of FDI to host economies. The economic rationale behind FDI is that multinational enterprises (hereafter MNEs) are capable to transfer technology that reduces environmental degradation in recipient countries. The study asks the question of whether foreign investment activities from the United States of America affect the environmental conditions in recipient countries and if it has the potential to enhance local environmental sustainability.

This study aims at understanding how MNEs may impact the natural environment of host countries seeking to attract FDI. Public opinion seems to be that any country may come under pressure to lower its environmental standards as governments seek to attract or retain economic activities and investors inside their national borders, propelling a "race to the bottom" on key regulations in areas such as environmental protection. Many environmentalists are concerned about the environmental consequences of corporate business activities around the world, where pollution-intensive industries seek countries with weak environmental standards, turning these locations into "pollution havens" (Eskeland & Harrison, 2003). On the contrary, the argument of the "pollution halo" refers to the possibility that MNEs and their FDI activities constitute an important vehicle for the transfer of green technology and economic development, reducing the impact upon the natural environment (Porter & Linde, 1995).

If investment abroad raises income, it allows countries to attain greater output leading to an increase in emissions while at the same time triggering countervailing tendencies by facilitating the introduction of "greener technologies" and influencing individual preferences for an unpolluted environment (Kozul-Wright & Fortunato, 2012). A number of scholars have attempted to answer the question of how MNEs are or will be impacted by the main requirements and regulations related to environmental issues (Pinkse & Kolk, 2012). However, few researchers have provided empirical evidence on how MNEs can contribute to environmental sustainability.

The purpose of this study is to explore the empirical relationship between FDI and the natural environment. This is done by testing the validity of the environmental Kuznets curve (hereafter EKC) on a panel dataset comprising 97 countries from 2004-2013. The EKC posits an inverted-U function between environmental degradation and income per capita. The Generalized Method of Moments panel estimator is used to obtain consistent and efficient estimates. This estimation method exploits the time-series variation in the data and controls for unobserved country-specific effects and endogeneity of the explanatory variables. In so doing, the research findings contribute to the debate on globalization and the natural environment. Critics of globalization assert that FDI is bad for the natural environment because it encourages the location of polluting industries in countries with poor environmental regulations. This question is also interesting because there is less research into the possibility of positive externalities from FDI and their impact on the natural environment. If, however, FDI is good for the natural environment, this weakens arguments for restricting foreign investment.

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