

# Chapter 14 Lecture : Foreign Finance, Investment, and Aid: Controversies and Opportunities

## ECON 211 – 70: Economic Development

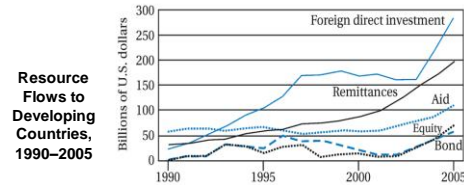
### Chapter 14 Lecture : Foreign Finance, Investment, and Aid: Controversies and Opportunities



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## The International Flow of Financial Resources

- Three sources:
  - Private direct and portfolio investment
  - Remittances of earnings by international migrants
  - Public and private development assistance



Source: World Bank, *World Development Indicators, 2007* (Washington, D.C.: World Bank, 2007), p. 314. Used with permission.

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## Multinational Corporations (MNCs)

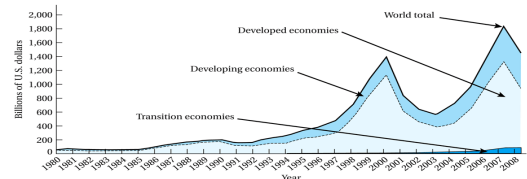
- Corporations that conduct and control productive activities in more than one country
- Large firms mostly from the U.S., Europe, and Japan
- 350 MNCs control 40% of international trade in primary and secondary products

<http://money.cnn.com/magazines/fortune/global500/2011/index.html>

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## Foreign Direct Investment (FDI)

- FDI is investment by MNCs
- FDI in LDCs rose from an annual rate of \$11 billion in 1980 to \$1,100 billion in 2000, but fell to \$600 in 2005
- Major recipients of FDI are China, Brazil, Argentina, and Mexico

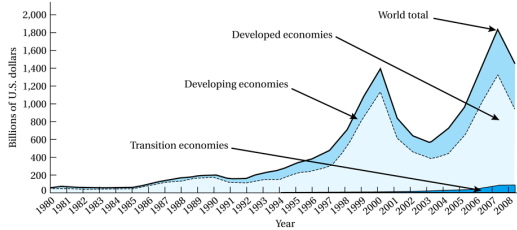


Source: World Investment Prospects Survey 2009–2011, Figure 1. FDI inflows, global and by group of economies, 1980–2008, p. 10, based on statistics at [www.unctad.org](http://www.unctad.org) and UNCTAD estimates. Reprinted with permission from the United Nations Conference on Trade and Development (UNCTAD).

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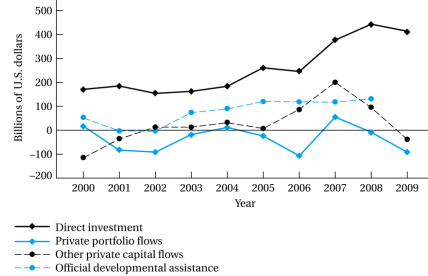
**Figure 14.1 FDI Inflows, 1980–2008**



Source: World Investment Prospects Survey 2009–2011, Figure 1. FDI inflows, global and by group of economies, 1980–2008, p. 10, based on statistics at [www.unctad.org/fdi](http://www.unctad.org/fdi) and UNCTAD estimates. Reprinted with permission from the United Nations Conference on Trade and Development (UNCTAD).

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**Figure 14.2 Net Capital Flows to Developing Countries, 2000–2009**



Source: From United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2009*, Chapter 1, p. 5. Reprinted with permission from the United Nations. Note: Drawn from IMF data which includes new EU member states from eastern Europe but excludes the now high-income South Korea and Singapore.

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## FDI Debate: Pros

FDI fills the

- Saving gap: causing economic growth
- Foreign-exchange gap: improving the BOP
- Tax revenue gap: raising funds for public spending
- Management gap: improving entrepreneurship
- Technology gap: facilitating industrialization

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## FDI Debate: Cons

MNCs

- Don't reinvest their profit
- Return profits to their headquarters through transfer pricing
- Create income for semi-skilled labor with low saving propensities
- Deteriorate current account through importation of capital goods and intermediate products
- Deteriorate capital account through outflow of profits
- Receive investment tax credits and are exempt from tariffs
- Hinder development of domestic managerial skills
- Gain monopoly power
- Reinforce dualism, increase income inequality, and induce R-U migration
- Influence local politics and support "friendly" governments

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## Seven Key Disputed Issues about the Role and Impact of MNCs in LDCs

1. International capital movements (income flows and balance of payments)
  - Do they bring in much capital (savings)?
  - Do they improve the balance of payments?
  - Do they remit "excessive" profits?
  - Do they employ transfer pricing and disguise capital outflows?
  - Do they establish few linkages to the local economy?
  - Do they generate significant tax revenues?
2. Displacement of indigenous production
  - Do they buy out existing import-competing industries?
  - Do they use their competitive advantages to drive local competitors out of business?
3. Extent of technology transfer
  - Do they keep all R&D in home countries?
  - Do they retain monopoly power over their technology?
4. Appropriateness of technology transfer
  - Do they use only capital-intensive technologies?
  - Do they adapt technology to local factor endowments or leave it unchanged?

## Seven Key Disputed Issues about the Role and Impact of MNCs in LDCs

5. Patterns of consumption
  - Do they encourage inappropriate patterns of consumption through elite orientation, advertising, and superior marketing techniques?
  - Do they increase consumption of their products at the expense of other (perhaps more needed) goods?
6. Social structure and stratification
  - Do they develop allied local groups through higher wage payments, hiring (displacing) the best of the local entrepreneurs, and fostering elite loyalty and socialization through pressures for conformity?
  - Do they foster alien values, images, and lifestyles incompatible with local customs and beliefs?
7. Income distribution and dualistic development
  - Do they contribute to the widening gap between rich and poor?
  - Do they exacerbate urban bias and widen urban-rural differentials?

Source: Based on Thomas Biersteker, *Distortion or Development: Contending Perspectives on the Multinational Corporation* (Cambridge, Mass.: MIT Press, 1978), ch. 3.

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## The Role and Growth of Remittances

- Wages and salaries made in a host country, but sent back to the home country
- Wage differences
- "Brain Drain"
- Uneven flow of remittances

[http://www.dilipratha.com/index\\_files/G8Berlin.pdf](http://www.dilipratha.com/index_files/G8Berlin.pdf)

**Table 14.1 Major Remittance-Receiving Developing Countries, by Level and GDP Share, 2008**

	Inflow of Migrants' Remittances (millions of U.S. dollars)	Annual Change (%)	Share of Remittances in GDP (%)
<b>Ranked by volume</b>			
India	45,000	27.8	3.7
China	34,490	5.0	0.8
Mexico	26,212	3.4	2.4
Philippines	18,268	12.1	10.8
Nigeria	9,979	8.2	4.7
Egypt	9,476	23.8	3.8
Bangladesh	8,979	38.8	11.0
Pakistan	7,028	17.1	4.2
Morocco	6,730	0.0	7.6
Indonesia	6,590	5.3	1.3
Lebanon	6,000	4.0	20.7
Vietnam	5,500	0.0	6.1
Ukraine	5,000	11.0	2.8
Colombia	4,523	0.0	1.9
Russian Federation	4,500	9.7	0.3
<b>Ranked by share of GDP</b>			
Tajikistan	1,750	3.5	34.1
Lesotho	443	0.0	27.4
Moldova	1,550	3.5	25.3
Guyana	278	0.0	24.0
Lebanon	6,000	4.0	20.7
Honduras	2,801	6.7	19.8
Haiti	1,300	6.4	18.0
Nepal	2,234	30.0	17.8
Jordan	3,434	0.0	17.1
Jamaica	2,214	3.3	17.1
El Salvador	3,804	2.5	17.0
Kyrgyzstan	715	0.0	14.2
Nicaragua	771	4.2	11.5
Guatemala	4,440	4.4	11.2
Bangladesh	5,979	36.8	11.0

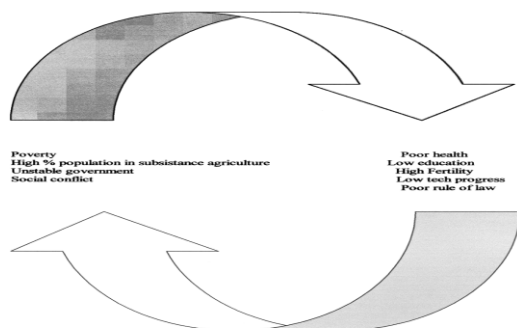
Source: UNCTAD Trade and Development Report, p. 23. (New York: United Nations, 2009), tab. 1.6. Reprinted with permission from the United Nations.

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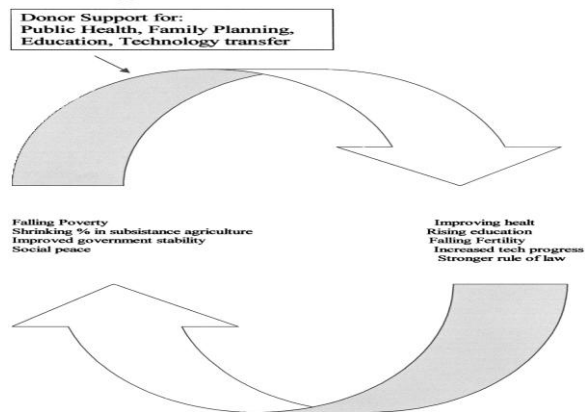
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## Vicious Circles in Economic Development



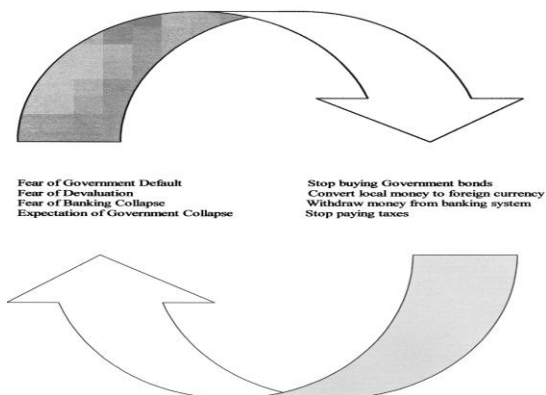
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## Breaking the Vicious Circles



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## Economic Panic



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## Some Issues and Terminology in Foreign Assistance

- Demonstration of Need
- Level of Need
- Conditionality
- Fungibility - an aid donor gives money to build a primary school in a poor country. If the recipient government would have built the school anyway, then the consequence of the aid is to release resources for the government to spend on other items. Thus, while the primary school may still get built, the aid is financing some other expenditure (or tax reduction) by the government. In such a case, donor assistance is said to be fungible.
- Monitoring and Accountability
- Bilateral - Multilateral
- Project aid - Programme aid
- Concessional flows
- Nonconcessional flows
- Benefit of aid = grant element
- Tied Aid - Untied aid
- Value of aid = benefit - cost of tying
- Return to assistance is its impact on growth
- UN aid targets

<http://www.globalissues.org/TradeRelated/Debt/USAid.asp>

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## Reasons for AID

- Moral – humanitarian
  - Relief from absolute poverty
- Political, military, historical
- Economic interests
- Distribution of aid depends on the motive
  - Should we give where return is highest?
  - Or where need is highest?
- Does aid help?
  - Still underdevelopment
  - Support to right governments / policies?
- Aid fatigue (=reluctant donor countries)

## Aid Questions

- How to increase aid flows?
- How to make aid more effective?

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## Foreign Aid

All governmental resource transfers from one country to another

- Expressed in real terms
- Exclude military aid
- Exclude transfers from private foreign investors
- Must be allocated to economic development projects and programs

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## Kinds of Foreign Aid

- Official Development Assistance: grants and loans
- Tide aid: the donor requires the recipient to use the funds to import products from companies in the donor country
- Untied aid: the donor provides assistance for developmental projects and plans

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**Table 14.2 Official Development Assistance Net Disbursements from Major Donor Countries, 1985, 2002, and 2008**

Donor Country	1985		2002		2008	
	Billions of U.S. Dollars	Percentage of GNI	Billions of U.S. Dollars	Percentage of GNI	Billions of U.S. Dollars	Percentage of GNI
Canada	1.6	0.49	2.0	0.28	4.8	0.33
Denmark	—	—	1.6	0.96	2.8	0.87
France	4.0	0.78	5.5	0.38	10.9	0.40
Germany	2.9	0.47	5.3	0.27	14.0	0.40
Italy	1.1	0.26	2.3	0.20	4.9	0.23
Japan	3.8	0.29	9.3	0.23	9.6	0.20
Netherlands	1.1	0.91	3.3	0.81	7.0	0.86
Sweden	—	—	2.0	0.83	4.7	1.00
United Kingdom	1.5	0.33	4.9	0.31	11.5	0.40
United States	9.4	0.24	13.3	0.13	8.0	0.18
Total (22 countries)	29.4	0.35	58.3	0.23	121.5	0.45

Source of data: World Bank, *World Debt Tables, 1991–1992* (Washington, D.C.: World Bank, 1992), vol. 1, tab. 2.1; World Bank, *World Development Indicators, 2004 and 2010* (Washington, D.C.: World Bank, 2004, 2010), tabs. 6.9 and 6.10.

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## Reasons for FA Donation

### Economic

- Assist with economic development and technology transfer
- Help in case of emergency (e.g., natural disasters)
- Assist with economic transition (e.g., former Soviet republics)
- Saving gap: causing economic growth
- Foreign-exchange gap: improving the BOP
- Technology gap: facilitating industrialization given absorptive capacity limitation

### Political

- Assist “friendly” government to succeed
- Promote “national security” by shifting FA from one country or region to another
- Can you think of others?

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## Criticism of the Donor Countries

- FA won't necessarily assist the poor people of the LDCs
- FA assists non-democratic and corrupt LDC governments
- FA is just a small percentage of GDP of donor countries  
FA is mostly in the form of loans rather than grants; FA is mostly tied
- FA discourages production, competition, and self-reliance of the recipient nations
- FA is abused as an election propaganda in both donor and recipient countries

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## New View of FA

- Make aid need-based to reduce poverty and overpopulation
- Provide more grants and less loans and more untied aid
- Promote self-reliant development
- Provide economic rather than political aid
- Help expand and strengthen the NGOs
- Understand that in the long-term, there can't be a dual future for the mankind, one for the very rich and one for the very poor, without the proliferation of global or regional conflict

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