

# Economic Development

12th Edition

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## Chapter 14

### Foreign Finance, Investment, Aid, and Conflict: Controversies and Opportunities



# 14.1 The International Flow of Financial Resources

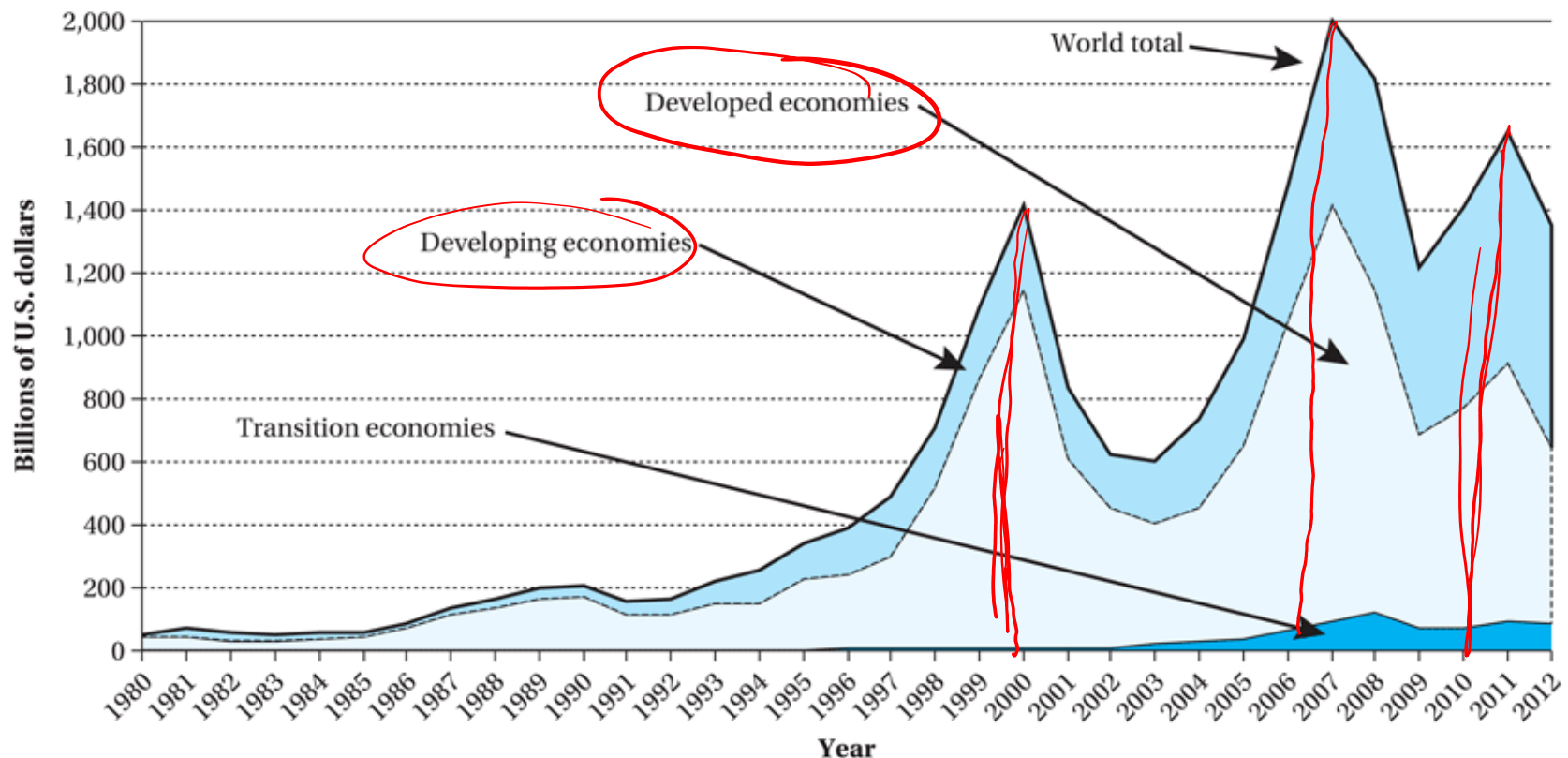
- Three sources:
  - Private direct and portfolio investment
  - Remittances of earnings by international migrants
  - Public and private development assistance



## **14.2 Private Foreign Direct Investment and the Multinational Corporation**

- Multinational Corporation (MNC)
  - Recent growth of foreign direct investment (FDI)

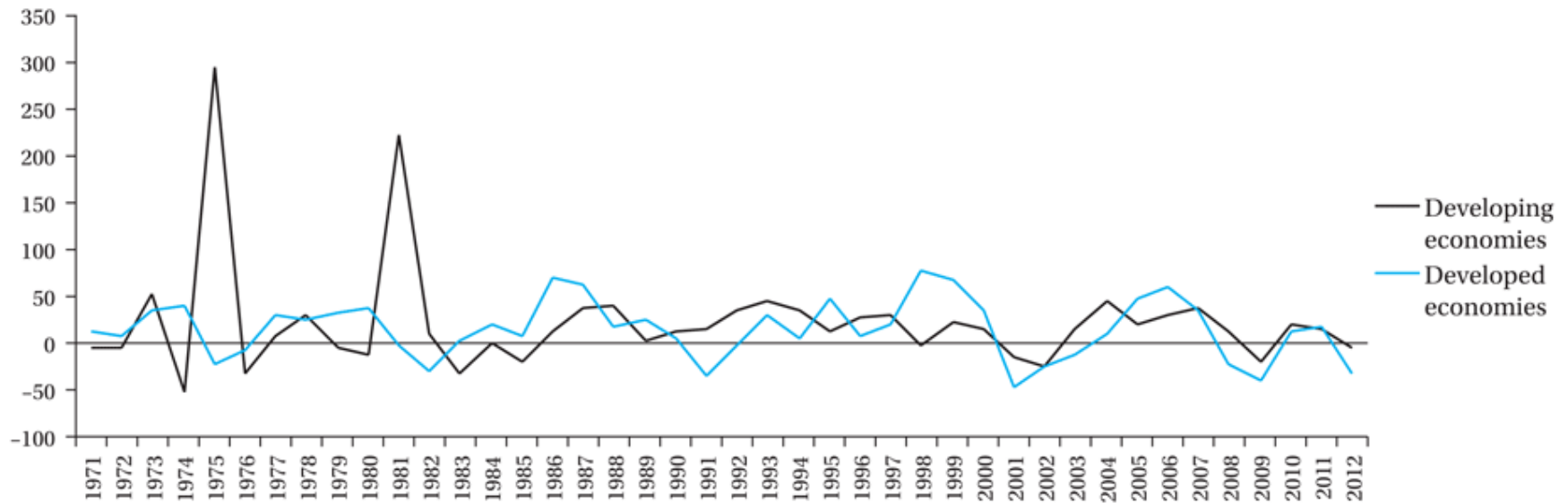
**Figure 14.1** FDI inflows, Global and By Group of Economies, 1980–2012 (Billions of Dollars)



Source: Data drawn from UNCTAD data base at <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, accessed 14 March 2014.



**Figure 14.2** Trends in Annual Growth Rates of FDI Inflows, by Groups of Economies, 1970–2012 (Percent)



Source: World Investment Report 2013, page 71. Reprinted with permission from the United Nations Conference on Trade and Development (UNCTAD).



## **14.2 Private Foreign Direct Investment and the Multinational Corporation (cont'd)**

- Private Foreign Direct Investment and the Multinational Corporation



## **14.2 Private Foreign Direct Investment and the Multinational Corporation (cont'd)**

- Private Foreign Investment: Pros and Cons for Development
- Traditional arguments in support of private investment: Filling savings, foreign exchange, revenue, and management gaps
  - Four main arguments





## 14.2 Private Foreign Direct Investment and the Multinational Corporation (cont'd)

- Private Foreign Investment: Pros and Cons for Development
- Traditional arguments against private foreign investment: Widening gaps
  - Two main perspectives of the arguments: Economic and ideological
  - Transfer pricing
  - See Box 14.1
- Reconciling pros and cons

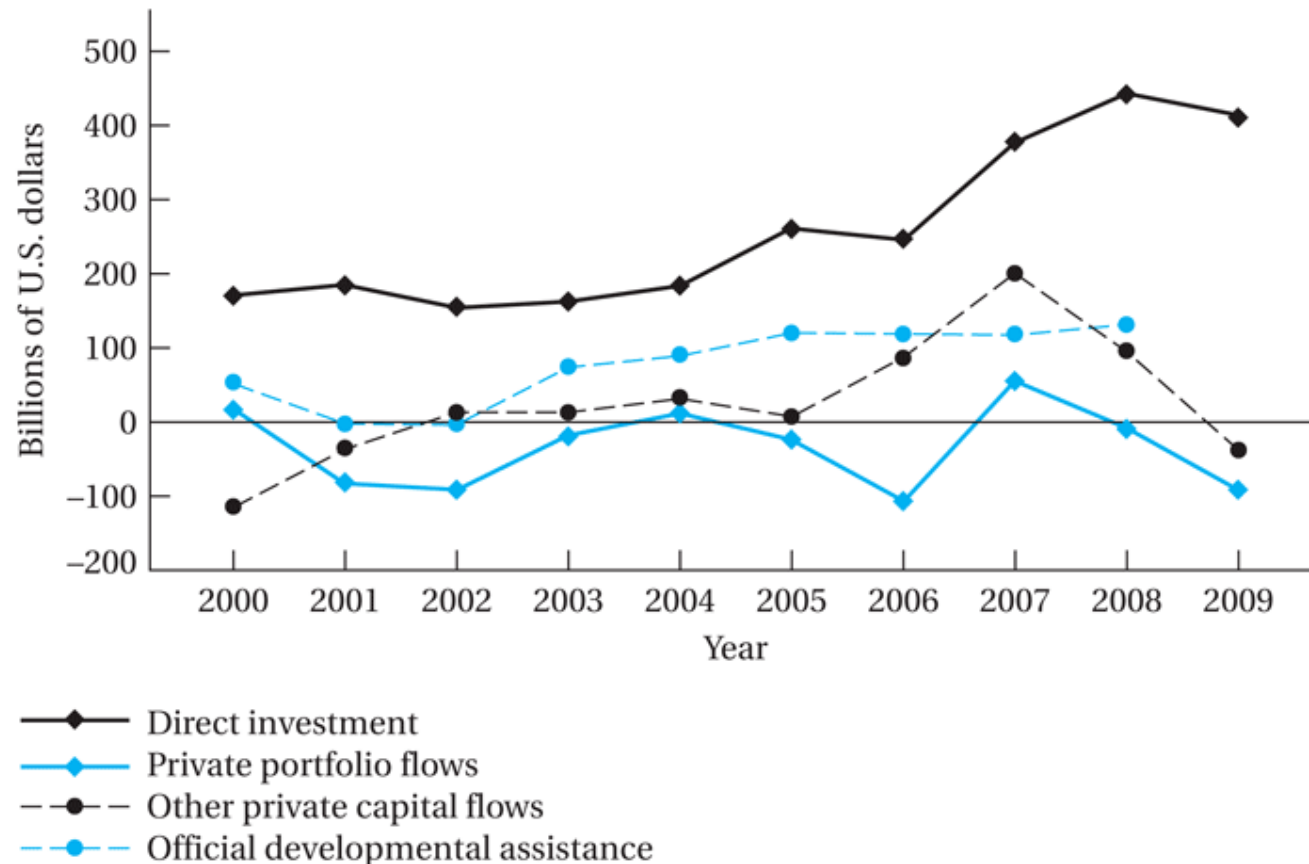




## 14.2 Private Foreign Direct Investment and the Multinational Corporation (cont'd)

- Private Portfolio Investment: Benefits and Risks?
- What is portfolio investment? *Finance*
- Emerging-country stock markets

**Figure 14.3** Net Capital Flows to Developing Countries, 2000–2009



Source: From United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2009*, ch. 1, p. 5. Reprinted with permission from the United Nations.

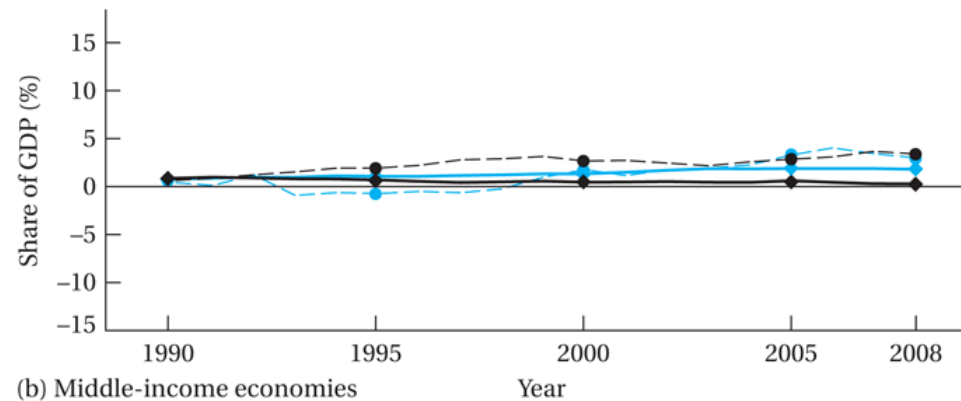
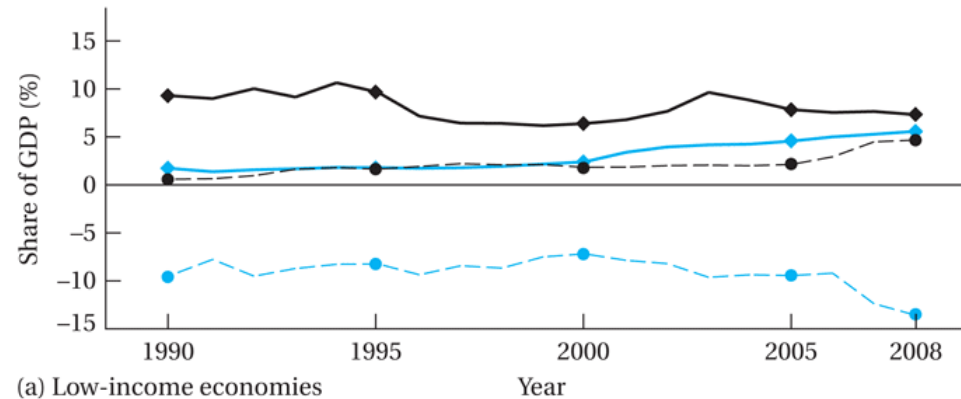
Note: Drawn from IMF data, which include new EU member states from eastern Europe but excludes the now high-income South Korea and Singapore.



## 14.3 The Role and Growth of Remittances

- Wage differences
- “Brain Drain”
- Uneven flow of remittances

# Figure 14.4 Sources of External Financing for Developing Countries, 1990–2008



—◆— Net aid received  
 —◆— Remittances received  
 -●- Foreign direct investment net inflows  
 -●- Net exports of goods and services

Source: International Bank for Reconstruction and Development/The World Bank, *World Development Indicators*. Copyright © 2010 The World Bank. Reprinted with permission.



**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	5.8
Bangladesh	8,979	38.8	11.0
Pakistan	7,025	17.1	4.2
Morocco	6,730	0.0	7.6
Indonesia	6,500	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	2,254	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.



## 14.4 Foreign Aid: The Development Assistance Debate


- Conceptual and measurement problems
- Amounts and allocations: public aid
  - Official development assistance (ODA)

**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.





## Table 14.3 Official Development Assistance (ODA) by Region, 2008

Region	ODA per Capita (U.S. \$)	GNI per Capita (U.S. \$)	ODA as a Share of GNI (%)
Middle East and North Africa	73	3,237	1.9
Sub-Saharan Africa	49	1,077	4.3
Latin America and the Caribbean	16	6,768	0.2
East Asia and the Pacific	5	2,644	0.2
South Asia	8	963	0.8
Europe and Central Asia	19	7,350	0.2

Source of data: World Bank, *World Development Indicators, 2010* (Washington, D.C.: World Bank, 2010), tabs. 1.1 and 6.16.



## 14.4 Foreign Aid: The Development Assistance Debate (cont'd)

- Why donors give aid
  - Political motivations
  - Economic motivations: two-gap models and other criteria
    - Foreign exchange constraints
    - Growth and savings
    - Technical assistance
    - Absorptive capacity
    - Economic motivations and self-interest



## 14.4 Foreign Aid: The Development Assistance Debate (cont'd)

The two-gap model:  
*savings constraint*

$$I \leq F + sY \quad (14.1)$$

Where

$I$  is domestic investment

$F$  is the amount of capital inflows

$s$  is the savings rate

$Y$  is national income



## 14.4 Foreign Aid: The Development Assistance Debate (cont'd)

The two-gap model:  
*foreign-exchange constraint*

$$(m_1 - m_2)I + m_2Y - E \leq F \quad (15.2)$$

Where

$I$  is domestic investment

$F$  is the amount of capital inflows

$E$  is the level of exports

$Y$  is national income

$m_1$  is the marginal import share

$m_2$  is the marginal propensity to  
import



## **14.4 Foreign Aid: The Development Assistance Debate (cont'd)**

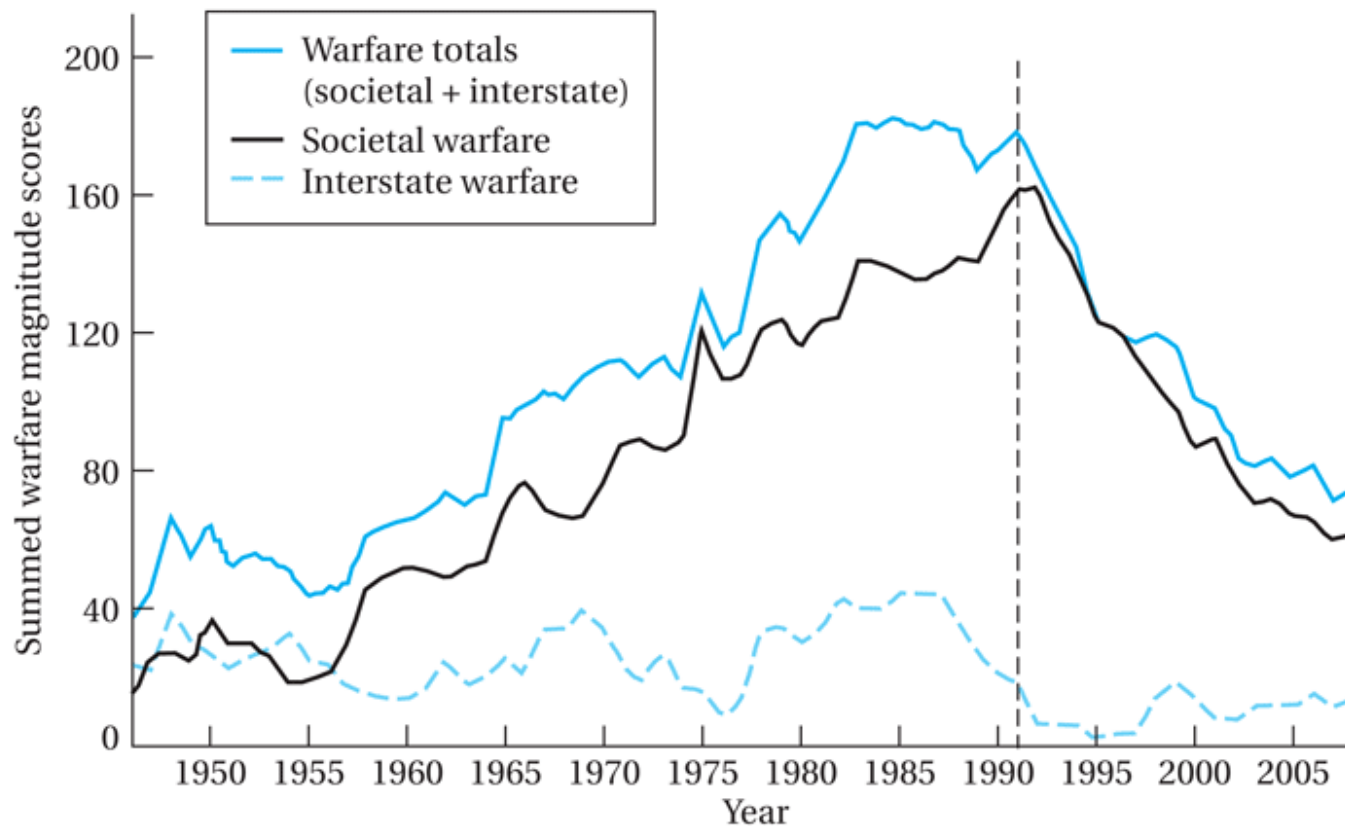
- Why recipient countries accept aid
- The role of nongovernmental organizations in aid (NGOs)
- The effects of aid



## 14.5 Conflict and Development

- The scope of violent conflict and conflict risks
- The consequences of armed conflict
  - Health
  - Destruction of wealth
  - Worsening hunger and poverty
  - Loss of education
  - A torn social fabric

## **Figure 14.5** Global Trends in Armed Conflict, 1946–2008



Source: Monty G. Marshall and Benjamin R. Cole, *Global Report 2009: Conflict, Governance, and State Fragility*, Center for Global Policy and Center for Systemic Peace, Systemicpeace.org, December 7, 2009. Reprinted with permission from the Center for Systemic Peace.





## 14.5 Conflict and Development (cont'd)

- The causes of armed conflict and risk factors for conflict
  - Horizontal inequalities
  - Natural resources for basic needs
  - Struggle to control exportable natural resources



## 14.5 Conflict and Development (cont'd)

- The resolution and prevention of armed conflict
  - Importance of institutions; e.g. addressing commitment problems
  - Global actors
  - Regional actors: an Africa-wide approach
  - National actors
  - Focus on education
  - Local, “community-driven” economic development



# Concepts for Review

- Absorptive capacity
- Commitment problem
- Concessional terms
- Foreign aid
- Foreign direct investment (FDI)
- Foreign-exchange gap
- Global factories
- Multinational corporation (MNC)
- Nongovernmental organizations (NGOs)
- Official development assistance (ODA)
- Portfolio investment
- Savings gap
- Technical assistance



# Concepts for Review (cont'd)

- Tied aid
- Transfer pricing
- Two-gap model