Chapter 14

Foreign Finance, Investment, and Aid: Controversies and Opportunities
Three Topics

1. Capital Inflows
   - Private
     • Direct Investment
     • Portfolio Investment
   - Official Development Assistance (ODA)

What are the Trends, Why?, Controversies, e.g. Does Foreign Aid Stimulate Growth?
Three Topics

1. Capital Inflows
2. Worker Remittances: Source of Income and Foreign Exchange, Trends
3. Armed Conflict: Trends, Why, What to do
Figure 14.1  FDI Inflows, 1980–2008

14.2 Private Foreign Direct Investment and the Multinational Corporation (MNC)

- MNCs seek:
  - High financial returns, and
  - Safety
  - Not development of poor countries, per se

- MNCs shun Risky countries:
  - Severe debt problems
  - Unstable governments
  - Inefficient and/or biased court systems

- Doug: “Good” Government is crucial for development
Figure 14.2  Net Capital Flows to Developing Countries, 2000–2009

[Graph showing net capital flows from 2000 to 2009 with lines indicating different types of capital flows: Direct investment, Private portfolio flows, Other private capital flows, and Official developmental assistance.]


Note: Drawn from IMF data which includes new EU member states from eastern Europe but excludes the now high-income South Korea and Singapore.
Private FDI: Pros and Cons for Development

• Pros:
  1. Increase Investment (Chapter 3, again!)
  2. Provide foreign exchange \( (\text{if desire higher exchange rate}) \)
  3. Tax revenue
  4. Introduce technology and management
Private FDI: Cons for Development

1. May substitute for domestic Investment
2. May inhibit expansion of domestic firms
   • By outcompeting them
   • By importing intermediate products
   • By receiving monopoly power from government
Private FDI: Cons (continued)

1. May substitute for domestic Investment
2. May inhibit expansion of domestic firms
3. Initial capital inflow offset by imports of capital and intermediate goods, profit repatriation
4. Transfer pricing limits tax revenues to DC
5. Little spillover of technology and management
6. MNCs use their power to extract favorable policies from DC governments
T-S Conclude:

• “... private foreign investment *can* be an important stimulus to economic and social development as long as the interests of MNCs and host-county governments coincide (assuming, of course, that they don’t coincide along the lines of dualistic development and widening inequalities). P.693
Doug says:

1. Development almost always involves dualistic development (traditional v modern) and widening inequalities (as some moved ahead faster than others). Look at China.

2. I get worried when “the interests of MNCs and host-country governments coincide,” for host-country governments are often not “good” governments. Or,

3. Yes, MNCs can do more harm than good, especially with the aid of “bad” governments.
Does Foreign Aid Promote Growth?

1. How Large is Foreign Aid (ODA)?
2. Which Countries Receive Foreign Aid?
3. Why Do Donors Give Aid?
4. Conflicting Views on the Effects of Aid
### Table 14.2 Official Development Assistance Net Disbursements from Major Donor Countries, 1985, 2002, and 2008

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

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

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

Aid Recipients: 2008

Largest:
1. Iraq: $9.9 Billion = $321 per capita
2. Afghanistan: $4.9 Billion = $168 per capita

• Other Examples:
  – Jordan (middle income country): $126 per capita
  – Niger (poorest in the world): $41 per capita
3. Why donors give aid

• Political motivations
  – Fight communism (until 1989)
  – Keep friendly governments, esp. in strategic locations

• Economic motivations
  – Capital Inflow to Promote Growth
  – Technical assistance
  – Self-interest of donor country exporters
Why recipient countries accept aid

- May believe that it will promote growth
- May help existing political leadership to remain in power
- And possibly to fatten their bank accounts
Conflicting Views on the Effects of Aid

• Methodological Difficulty: To the (limited) extent that countries focus aid on poor countries, aid and poverty are positively correlated.
• But that does NOT imply aid causes poverty
• It is methodologically difficult to sort out the evidence
Conflicting Views on the Effects of Aid

• Positive View of Aid:
  – Fills Saving Gaps
  – Finances Investment in Human Capital
  – Is used as a lever to promote “good” government (“conditional” aid)
Conflicting Views on the Effects of Aid

- Negative View of Aid:
  - Substitutes for domestic savings
  - Rising debt obligations when funds are poorly invested or stolen or bad luck occurs
  - Worsens income inequalities (T-S are sooooo tiresome on this!)
  - Creates dependency ("Welfare mentality")
Conflicting Views on the Effects of Aid

• Evidence
  – As said, hard to evaluate statistically
  – Case studies on both sides:
    • Clearly, some aid projects have been successful
    • Clearly, some aid projects have not been successful
2. The Role and Growth of Remittances

DC country people working abroad and sending income back to DC

- Latin Americans working in US
- Indians working in the Gulf States, US ...
- Chinese working in Singapore, Malaysia, US ...
- Filipinos working in Morocco, ...

...
Figure 14.3 Sources of External Financing for Developing Countries, 1990–2008

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

<table>
<thead>
<tr>
<th>Ranked by volume</th>
<th>Remittances (millions of U.S. dollars)</th>
<th>Annual Change (%)</th>
<th>Share of Remittances in GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>45,000</td>
<td>27.8</td>
<td>3.7</td>
</tr>
<tr>
<td>China</td>
<td>34,490</td>
<td>5.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Mexico</td>
<td>26,212</td>
<td>3.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Philippines</td>
<td>18,268</td>
<td>12.1</td>
<td>10.8</td>
</tr>
<tr>
<td>Nigeria</td>
<td>9,979</td>
<td>8.2</td>
<td>4.7</td>
</tr>
<tr>
<td>Egypt</td>
<td>9,476</td>
<td>23.8</td>
<td>5.8</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>8,979</td>
<td>38.8</td>
<td>11.0</td>
</tr>
<tr>
<td>Pakistan</td>
<td>7,025</td>
<td>17.1</td>
<td>4.2</td>
</tr>
<tr>
<td>Morocco</td>
<td>6,730</td>
<td>0.0</td>
<td>7.6</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6,500</td>
<td>5.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Lebanon</td>
<td>6,000</td>
<td>4.0</td>
<td>20.7</td>
</tr>
<tr>
<td>Vietnam</td>
<td>5,500</td>
<td>0.0</td>
<td>6.1</td>
</tr>
<tr>
<td>Ukraine</td>
<td>5,000</td>
<td>11.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Colombia</td>
<td>4,523</td>
<td>0.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>4,500</td>
<td>9.7</td>
<td>0.3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ranked by share of GDP</th>
<th>Remittances (millions of U.S. dollars)</th>
<th>Annual Change (%)</th>
<th>Share of Remittances in GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tajikistan</td>
<td>1,750</td>
<td>3.5</td>
<td>34.1</td>
</tr>
<tr>
<td>Lesotho</td>
<td>443</td>
<td>0.0</td>
<td>27.4</td>
</tr>
<tr>
<td>Moldova</td>
<td>1,550</td>
<td>3.5</td>
<td>25.3</td>
</tr>
<tr>
<td>Guyana</td>
<td>278</td>
<td>0.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Lebanon</td>
<td>6,000</td>
<td>4.0</td>
<td>20.7</td>
</tr>
<tr>
<td>Honduras</td>
<td>2,801</td>
<td>6.7</td>
<td>19.8</td>
</tr>
<tr>
<td>Haiti</td>
<td>1,300</td>
<td>6.4</td>
<td>18.0</td>
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<tr>
<td>Nepal</td>
<td>2,254</td>
<td>30.0</td>
<td>17.8</td>
</tr>
<tr>
<td>Jordan</td>
<td>3,434</td>
<td>0.0</td>
<td>17.1</td>
</tr>
<tr>
<td>Jamaica</td>
<td>2,214</td>
<td>3.3</td>
<td>17.1</td>
</tr>
<tr>
<td>El Salvador</td>
<td>3,804</td>
<td>2.5</td>
<td>17.0</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>715</td>
<td>0.0</td>
<td>14.2</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>771</td>
<td>4.2</td>
<td>11.5</td>
</tr>
<tr>
<td>Guatemala</td>
<td>4,440</td>
<td>4.4</td>
<td>11.2</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>5,979</td>
<td>36.8</td>
<td>11.0</td>
</tr>
</tbody>
</table>

The Role and Growth of Remittances

- Remittances are an important and growing source of income in DCs
- World Bank studies indicate that remittances have substantially reduced poverty in countries such as Guatemala, Uganda, Ghana, and Bangladesh (and probably others).
Armed Conflict and Development

• The consequences of armed conflict
  – Health (Wounds/Death/Rape and decreased funding: higher child and maternal mortality)
  – Destruction of wealth/ reduced incentive to invest
  – Worsening hunger and poverty
  – Reduced education
  – A torn social fabric
Figure 14.4  Global Trends in Armed Conflict, 1946-2008

Armed conflict is more likely where:

- Government institutions are weak (can not keep the peace/prevent rioting/quell uprisings)
- Population is divided on parallel economic and ethnic lines
- Rising scarcity of (common property) natural resources (water, land), e.g. drouth
- Struggle to control exportable natural resources (diamonds, copper, etc.)
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