

Foreign investment in poor countries economics essay



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In this essay I will be discussing and arguing whether foreign investment is good / bad for poor countries and whether it should always be welcomed by them. Within the text I will be discussing the theory behind foreign investment, whilst highlighting the various pros and cons of the process and consequences for the poor host country. I will then back up the theory with past examples of foreign investment in practice, which will then lead me to summarise and evaluate whether poor countries should always welcome it.

First I am going to explain exactly what is meant by a poor country so that it's understood throughout the essay when relating to examples etc. Poor countries, aka third world or developing world countries, are described as 'the less economically advanced countries of Africa, Asia, and Latin America collectively' (Collins Discovery Encyclopedia, 2005); this is measured by the income per head of population of the country involved. Among the poorest countries in the world today are Zambia, Afghanistan, Sierra Leone and Bangladesh, however all these poor countries are labelled poor for different reasons e. g. political, economical, ethical and technological issues within the countries.

Second I am going to explain exactly what foreign investment is. There are two types of foreign investment which variably affect all parties in different ways - one of which is foreign direct investment (FDI). One definition of FDI describes it as 'one that gives the investor a controlling interest in a foreign country' (Daniels et al, 2007, p20), while another source sees it as 'a company from one country making a physical investment into building a factory in another country' (<http://www.going-global.com/>). Whilst I do feel both definitions are valid and explain FDI well, the second definition is more

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applicable in my eyes as it highlights exactly what FDI is and actually states that a company is 'investing' in building in a foreign country instead as just seeing it as an 'interest'.

FDI can take place either individually, where there's only one company involved in an investment, or a joint venture, where 'two or more companies share ownership of an FDI' (Daniels et al, 2007, p20). Brief examples of both these investments involve the Japanese businessman Yamauchi's individual ownership of the Seattle Mariners American baseball team and Disney's joint venture with the Hong Kong government to build a Disneyland theme park in Hong Kong. If company/companies has the majority of control of an FDI and the rest is dispersed widely, then the final decision lies with the companies with the most control and decisions by other owners can be countered.

In relation to foreign indirect investment (FII), aka portfolio investment, this is explained as a non-controlling interest in a company or ownership of a loan to another party' (Daniels et al, 2007, p20); it is also described as 'the purchase of stocks and bonds to obtain a return on the funds invested' (Ball and McCulloch, 1993, p43). The word 'non-controlling' in the first definition indicates clearly that the investor has no part to play in the actual direct investment itself and doesn't have a say in the purchasing process.

There are two different forms of FII that can be chosen: 'stock in a company or loans to a company or country in the form of bonds, bills, or notes that the investor purchases' (Daniels et al, 2007, p20). After the choice of FII has been chosen, the control then lies with the company that they have invested in to perform FDI in a foreign country. A brief example of FII in action is the

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part that Malcolm Glazer's foreign investment played in the running of Manchester United Football Club, where he had no control in the decision making of the club due to him not being the majority shareholder. This was, however, changed to a FDI when he bought more shares to become the majority investor which allowed him to control the investments he made (Daniels et al, 2007, p21).

There isn't too much of a difference between FDI and FII, however the main words to look at when separating the two investments are direction, control and tangibility. With FDI the investor has the control to directly invest or buy shares of a foreign company, which can be seen and are referred to as tangible. In FII the investor's control of the investment is non-existent and indirect with their money been spent on shares, bonds etc by an investment fund. Therefore the investor is not actually in touch with what the money is spent on and is seen as intangible. As explained in the Malcolm Glazer case, you can go from FII to FDI by buying more shares and being in touch with the investment.

I am now going to look more in depth into FDI and explain the benefits and drawbacks of the investment for the host country involved. There are many positive outcomes that FDI can bring to a country, some being more beneficial and important than others with relation to short or long term involvement. ' FDI has come to be seen as a major contributor to growth and development, bringing capital, technology, managing expertise, jobs and wealth' (Daniels et al, 2007, p165). The growth and development of a host country can be seen as the overall beneficiary of FDI, with the facilities provided by the investors providing opportunities for the nation and its

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population. With factories, you need factory workers, and with workers, you need the skills which enable you to complete the job in hand and handle the technologies involved, therefore training is essential to all parties. Training will enhance the knowledge and skills of the nation's people which will enable them to be more educated. As the job vacancies need to be filled, this provides work opportunities for the country people to come out of unemployment and work to provide for their families with a higher income. This results in a better lifestyle for the nation's population, the nation becoming wealthier and a lower unemployment rate for the country.

With positives there are always some negatives and the process of FDI is no different. One of which is the opinion of critics who ' contend that FDI destroys local entrepreneurship, an outcome that affects national development' (Daniels et al, 2007, p171). Even though FDI does bring with it job opportunities, are they for the right purpose? This statement disagrees with the argument in that the foreign investors come in to the host countries; use their natural resources to make money for their home countries. This is a good argument against FDI as foreign investors can halt the potential use of the host countries own natural resources which would result in them becoming a wealthier country with a higher level of GDP. Due to the intervention of FDI the level of local entrepreneurship does seem limited as wealthier investors have the facilities that the locals don't, which may result in a country developing slower. In addition to financial and economic drawbacks, there are also environmental issues regarding FDI as the factories used by the investors pollute the air with toxic gases which can affect the human surroundings.

I will now look at foreign investment in practice where I will examine a few examples, good and bad, of FDI in poor countries. Analysing the outcomes of the examples will aid me in coming up with a conclusion as to whether foreign investment should always be welcomed by poor countries.

The first example I am going to examine is the impact of FDI in the twin-island nation of Trinidad & Tobago, whom since investment barriers were eliminated in 1992 have 'experienced 16 consecutive years of real GDP growth through 2008'. This is highly due to the relationship between themselves and the United States (U. S) where 'the stock of U. S. direct investment in Trinidad and Tobago was \$3. 8 billion as of 2007'. This is a very significant figure as 'total foreign direct investment inflows over the four years 2004-2007 amounted to approximately U. S. \$3. 8 billion'. The resources that have been provided by T&T include mainly natural gases and liquefied natural gases which are dependent on to create the likes of iron and fertilizers. Resources like iron have been heavily included in recent projects: 'in December 2006, Nucor began producing direct reduced iron for shipment to the U. S. at its plant in Trinidad, which has a production capacity of 2. 0 million tons per year' ([http://www. state. gov/r/pa/ei/bgn/35638. htm](http://www.state.gov/r/pa/ei/bgn/35638.htm)).

The inclusion of FDI in such a struggling country like T&T has produced many benefits for the country: infrastructure plans including housing, roads and bridges, rural electrification, flood control, and improved water supply, drainage, and sewerage is offering the country with structures that will provide the population with better living conditions. Although late 2008 budget cuts driven by falling export revenue will delay the start of many new projects, this infrastructure improvement plan is one of the government's <https://assignbuster.com/foreign-investment-in-poor-countries-economics-essay/>

budget priorities. Other benefits include less expenditure on services such as telecommunications and broadband due to the increase in their competitions and a decrease in unemployment.

FDI in T&T has also provided cons for the country including the problem of traffic on roads. This is a worsening problem throughout Trinidad, as the road network is not well suited to the rising volume of vehicles and only a rudimentary mass transport system exists as an alternative. Another inconvenience is the flooding in the rainy season due to inadequate drainage affects urban and rural areas alike.

Overall I feel that FDI has been a revelation for T&T since the investment barriers were lifted in 1992. The relationship between the U. S and T&T has enabled the poor country to develop infrastructure and make more plans for development. Even though projects have been delayed, the plans for improved drainage and roads etc are to go ahead and will solve the problems mentioned such as flooding.