Is foreign direct investment (FDI) good for development?

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Introduction

In an era of globalization and free markets, the constant flow of goods, labor, and capital, has led to an interconnected world, where nations and corporations don't solely exchange, but often operate worldwide. However, the stark contrast between more developed Northern countries and less developed countries in the Global South persists and there are numerous explanations for the sustained differences in development. One perspective is Wallerstein's world-systems theory, which divides the globe into core, semi-periphery, and periphery regions, by researching patterns of economic flows. Despite originating in the 70s, the theory remains relevant today, evident in the $700 billion capital flows to the global South in 2014 (Pevehouse & Goldstein, 2021). Investments bring financial resources into an economy, prompting a crucial question: is this inherently a good thing, or do side effects of the foreign injection of capital in developing countries outweigh potential benefits? *This assignment will argue that foreign direct investment is bad for development because it can lead to multinational corporations exploiting the host countries in which they operate.* Initially, a brief introduction of the terms FDI, development, and the world-systems theory will be given. Secondly, ten supporting arguments detail the adverse effects of FDI, followed by a discussion of a neoliberal perspective. Finally, a conclusion will connect the most important features of the complexities surrounding FDI and its implications for development.

Theoretical framework

This paragraph defines the concepts of FDI and development. Capital flows include portfolio investments - stocks, loans, pure money - and foreign direct investment (FDI). The latter is defined as "the acquisition by residents of one country of control over a new or existing business in another country" (Pevehouse & Goldstein, 2021, p. 501), and often takes place by multinational corporations (MNCs) acquiring companies or factories in foreign countries. In the globalized world, MNCs, often originating from developed *home countries* in the Global North, have substantial political influence in international economic affairs, in some instances, their power surpasses that of *host country* governments, particularly in developing Global South nations (Pevehouse & Goldstein). *Development*, a complex concept, is examined in this paper with a focus on how FDIs impact the host country economically, socially, and environmentally. The United Nations defines development by stating those three areas of development as "interdependent and mutually reinforcing components of sustainable development" (UN, 1997). This definition guides this paper to research how all three types of development are affected by MNCs entering a foreign market (Orvis & Drogus, 2021).

The world-systems theory provides a structural lens to understand the global economic hierarchy and its underlying interdependencies; many of which are shaped by FDI. Inspired by a Marxist perspective on economic classes, Immanuel Wallerstein developed the theory separating the world into *core*, *semi-*

periphery, and *periphery* regions. The core consists of industrialized, economically advanced countries central to global economy, while the periphery counts less developed countries, often providing labor and extractive materials (Pevehouse & Goldstein, 2021). This assignment focuses on core and periphery countries, due to the pronounced development gap (UNDP, 2021), and primarily FDI to Sub-Saharan Africa. Colonial times exhibited a clear distinction between the colonizing core countries and the colonized periphery, but a 2012 analysis reveals that economic flows today are still deeply structured by basic power relations between core and periphery, with the 21st century core exclusively consisting of the United States and Western Europe (Van Hamme & Pion, 2012). Despite global economic liberalization, the historic economic connections have not been replaced, with Africa still dependent on capital flows, notably FDI by ex-colonizers UK, France, and the Netherlands (UNCTAD, 2022). This reliance reflects enduring economic ties rooted in centuries of exploitation.

Economic exploitation

Profit-driven MNCs strategically position themselves in foreign markets according to rational choice, ignoring the exploitative consequences for the host countries. From a Marxist perspective, multinational corporations can be seen as an embodiment of the capitalist upper class; in the world-systems perspective as the main economic forces from the core (Van Hamme & Pion, 2012). When deciding which markets to make foreign direct investment in MNCs can often be seen choosing rationally, where costs seem lowest and possible profits the biggest, perfectly aligning with the idea of capitalist pursuit of profit. Paying taxes in the host country could be one significant this contributes to the development, but multiple studies show that along with low wages, attractive corporate tax rates are highly prioritized when MNCs decide where to invest (Antonakakis & Tondl, 2015). Additionally, it is estimated that 30% of global FDI stocks are intermediated through tax havens (Haberly & Wójcik, 2015), thus underpinning the rational choice assumption. Governments can make special tax policies or industry-specific regulations to make the national economic climate more attractive to investment-seeking MNCs (Pevehouse & Goldstein, 2021). Arguably, this is an indirect form of exploitation of the host countries, considering the loss of potential state revenue that otherwise could have contributed to the development of the host country.

Big MNCs making FDI in developing countries crowd out the market and undermine smaller-scale domestic competitors. This might serve as an explanatory factor as to why periphery countries have a hard time developing, e.g. breaking the trade patterns with previous colonizers (Van Hamme & Pion, 2012). Crowding out should be understood as FDI displacing domestic private investment and there are multiple evident cases of this over the years (Morrissey & Udomkerdmongkol, 2012). For example, when U.S. and Japanese computer firms built export facilities in "Little Silicon Valley" in Mexico in the 90s, this coincided with a 71% decline in indigenous supplier firms, possibly simply outcompeted in their market by the MNCs

(Moran, 2011). Another type of crowding-out, directly caused by FDI is the case of the mining industry in Ghana. The Ghanaian government warmly welcomes foreign large-scale mining companies and incentivizes them to stay and operate in the country, whereas small-scale local mining companies are subject to "strong-arm measures" adopted by the government against their industry. This policy bias favors large-scale mining MNCs based on the idea that they bring economic growth and development; but it paradoxically results in a government neglecting an industry made up of its population once again; cementing the dependence on core states (Ayelazuno & Mawuko-Yeyugah, 2019; Van Hamme & Pion, 2012).

Social exploitation and loss of sovereignty

While foreign direct investment may create jobs in the host countries, they are often of such poor quality that they do not sustain long-term development. Many MNCs are driven by profit incentives, leading them to shift production to developing countries with low wages, to minimize operating costs (Antonakakis & Tondl, 2015). Most periphery countries have big labor forces requiring little pay, especially compared to the minimum wages of home countries where the low standards for work conditions would not be tolerated. This enables MNCs to generate profit relatively easily, particularly in industries like textile; where large numbers of workers can be hired for low cost, requiring little-to-no education (Pevehouse & Goldstein, 2021). In Bangladesh, one of the world's biggest textile producers, the ready-made garment sector received $1,229 million in FDI in 2023, nearly three times more than the second largest FDI sector (RMG Bangladesh, 2023). However, with the current monthly minimum wage in this sector being $113 - less than half the living wage at $302 estimated by the Bangladesh Institute of Labour Studies (Kashyap, 2023) - it is evident that in this case, FDI contributes to a sector far from contributing to development for the Bangladeshi population.

Not only do multinational corporations invest in industries with low wages and poor conditions, but evidence shows a race-to-the-bottom-like competition within said sectors hindering development. Vietnam's service sector exemplifies a direct link between an increased presence of foreign firms and lower wages paid by domestic firms (Nguyen, 2019). This shows that MNCs not only exploit lower production costs in peripheral nations like Bangladesh and Vietnam but also influence locally the markets they enter. Domestic firms may strategically lower their costs to adapt to the new market landscape and compete internationally, but the lower wages might also result from the negative spill-over effects of MNC operations. In some instances, effective workers from domestic firms are poached by the foreign firms offering higher wages, leading to a setback for those left behind; in Vietnam one percentage point increase in foreign presence causes average wage levels of domestic firms to decline by approximately 4.5 percent (Nguyen, 2019). In today's globalized world, it is also noteworthy that the peripheric markets not only

compete with MNCs domestically but with other peripheries internationally. I.e. the Mexican manufacturing sector slowed down at the beginning of the 2000s facing competition from cheap labor in China, but has grown again in recent years, simultaneously with Chinese wage rates rising (Orvis & Drogus, 2021).

Another way in which FDI halts development in a host country is by potential loss of national sovereignty. In some developing countries governments are simply less powerful and wealthy than the MNCs investing, which highlights another aspect of the power imbalance in the world-systems theory. Governments voluntarily aiming policies to gain investments is one thing, but once MNCs have entered domestic markets, small governments might find themselves in a position unable to refuse demands made by billion-dollar corporations. A case illustrating these worries is the 2010 merger of South African Mass-Mart and one of the world's biggest MNCs, the US$204.8 billion empire of American Walmart. Not only did skeptics fear the persuasive power that the magnitude of the corporation might have on the South African government, but Walmart is a clear example of how globalization has led to a worldwide standardized workplace, which might undermine a state's ability to rely on national pride and identity to exert power and sovereignty (Bezuidenhout & Kleynhans, 2015; Pevehouse & Goldstein, 2021). Furthermore, operating out of the United States, local subsidiaries are bound to adhere to the regulations of the home country, in this case implying that South Africa de facto has very little legal recourse against effects owing to the actions of an MNC (Bezuidenhout & Kleynhans, 2015).

Environmental exploitation

FDI can facilitate developing countries being exploited environmentally as so-called *pollution havens.* In a parallel to the race-to-the-bottom scenario in labor standards, attracting MNCs may lead to lower environmental regulation standards in developing countries. Empirical evidence highlights that pollution-intensive industries prefer locations with lenient environmental standards, while some host countries seeking growth at all costs may disregard or fail to enforce domestic standards to attract investors - behavior often endorsed by MNCs (Mabey & McNally, 1999). *Pollution havens* refer to this phenomenon where the global North, primarily core countries, load parts of their environmental burden on the global South. This allows MNCs to adhere to stringent environmental laws in their home country while directing FDI flows to countries with weak enforcement or lax regulations (Pradhan, Sahu, & Mohindra, 2022). Not only does most FDI inflow happen in dirty polluting industries, like light manufacturing in Pakistan or textiles in Bangladesh (Rashid Khan, Nassani, Aldakhil, & Qazi Abro, 2019; RMG Bangladesh, 2023), but a 2016 rapport shows that FDI increases CO^2 emissions (Baek, 2016), reinforcing the pollution haven theory. Illustrating this, Nigeria, a major contributor to the American oil market, experiences an annual oil spill

equivalent to the significant Exxon Valdez oil spill in Alaska in 1989, underlining the disproportionate environmental costs borne by citizens of one of the poorest countries (Orvis & Drogus, 2021).

The notion that economic development will eventually reach a turning point, thus facilitating environmental development, might create a false sense of security to host countries welcoming polluting FDIs.
The Environmental Kuznets Curve (EKC) hypothesis posits an inverted U-shape relationship between economic development and environmental damage, implying that a threshold will be reached where economic growth aligns with long-term environmental quality (Pradhan, Sahu, & Mohindra, 2022). However, with continuous global growth and rising consumption levels, achieving compatibility seems long delayed - the environment in many developing countries degrades despite economic growth, signaling that economic development cannot be the sole focus. Multiple studies reveal an increasing trend in municipal waste, CO^2 emissions, biodiversity loss, and declining local air quality with greater income (Mabey & McNally, 1999; Pradhan, Sahu, & Mohindra, 2022). China, now the world's largest steel producer, experienced economic gains from American FDI shifting steel production from Pittsburg. However, this led to severe air pollution issues in Chinese cities, while Pittsburg simultaneously saw an improvement of air quality as the steel production was outsourced (Orvis & Drogus, 2021). Even if some might believe in a future global turning point of EKC, globalization-induced pollution and nonrenewable resource use might cause irreversible effects before this level could ever be reached.

The extractive sector and the resource curse

Many host countries find little to no benefits from FDI in their extractive sectors, despite their nations' resources generating billions; the repeating pattern of the resource curse prevents development. The resource curse is the paradoxical idea that countries with abundant and valuable natural resources tend to do poorly. This occurs when a state heavily relies on a key resource for most of its revenue, leading to neglect of citizens and resulting in a weak state (Orvis & Drogus, 2021). Historically geographical areas rich with natural resources have seen intense competition and conflicts by the powerful; previously colonizers, today MNCs (Ayelazuno J. , 2014). Notable examples of resource-curse-bound countries exist in Sub-Saharan Africa, like Ghana's mining industry or the oil sectors in Angola and Nigeria (Ayelazuno & Mawuko-Yeyugah, 2019; Pevehouse & Goldstein, 2021). Assessed through the world-systems theory, the deep-rooted power imbalance between core and periphery (in this case oil MNCs and Sub-Saharan resource-rich states) explains why the wealth from the resources extracted has not catalyzed economic growth and citizen well-being. FDI in extractive sectors lacks positive feedback towards the broader economy, as most profits are funneled directly into core economies, hindering local capital accumulation (Ayelazuno J. , 2014; Van Hamme & Pion, 2012).

Another impediment to FDI contributing to development in host countries is the extent of corruption involved, particularly in sectors like extractive industries, as highlighted by Transparency International (Moran, 2011). For example, an ExxonMobil Oil executive paid $78 million to secure the MNC a billion-dollar contract in Kazakhstan through corrupt means. Corruption tends to be more prevalent in developing countries with economies reliant on a narrow range of exports, such as oil or mining, due to concentrated revenue and weaker institutions (Pevehouse & Goldstein, 2021). Notably, during Nigeria's industrialization many private investors were political officials, so partaking in the rising markets strongly depended on government ties and vice versa, contributing to the emergence of a highly corrupt society, blurring lines between investors and the overseeing institutions (Orvis & Drogus, 2021). Post-independence in Sub-Saharan Africa, many developing countries are trapped in a vicious cycle where the legacy of colonial rule combined with the newness of democracy leads to weak governance and diminishes the perceived value of institutions, enabling more corruption. This interconnectedness of corruption, economic dependence, and institutional fragility shows the multifaceted challenges faced by developing nations in realizing the potential benefits of FDI for sustainable development (Orvis & Drogus, 2021).

"Capital does not "flow" from New York to Angola's oil fields (…); it hops, neatly skipping over most of what is in between" (Ferguson, 2006) In many cases, FDI in extractive sectors in Sub-Saharan Africa leads to enclave industries, weakly integrated with the broader economy, with insubstantial spillovers to the greater development (Ayelazuno J., 2014). A depicting example is the enclave economy of Angola's Cabinda province, where American oil employees live a civilized Western lifestyle inside a secured compound, whilst the people of Cabinda, aside from a tiny number working for ExxonMobil and Chevron, live in contrasting poverty right on the outside of the fences (Pevehouse & Goldstein, 2021). From a world-systems theory perspective, this enclave example fits into the dynamics of a core-periphery relationship, where the MNC-dominated oil industry operates as a Western core entity extracting resources from the periphery, reinforcing global economic inequalities. Except for the oil itself, most or all the phases of the value chain are undertaken by the MNCs, not the locals, who expatriate the profits back to their home countries (Ayelazuno J. , 2014).

Discussing the neoliberal perspective

An opposing argument could be made from a neoliberal perspective that FDI is good because free-market capitalism and the role of MNCs foster economic development in a host country. Neoliberalism centers around allowing the free market to allocate resources efficiently and a diminished government role in the economy (Orvis & Drogus, 2021). Following the 1980s debt crisis, global governance shifted developmental focus from poverty alleviation to stabilizing world markets; claiming that development would follow naturally. This paradigm shift led to the promotion of neoliberal development models like

Structural Adjustment Programs imposed by the IMF and the World Bank, where developing countries could achieve loans conditioned by making macro-economic reforms; including opening domestic markets up for more FDI (Rojas & Kindornay, 2014; Pevehouse & Goldstein, 2021). However, basing development solely on the economy is not durable. Weak institutions can undermine potential developmental benefits of the money obtained through FDI. A 2012 study of Nigeria's oil sector showed that a combination of domestic and international malfeasance had cost the government $100 billion in the last decade (Orvis & Drogus, 2021). Recent efforts have addressed the consequences of FDI, such as the Guiding Principles on Business and Human Rights endorsed by the UN in 2011 and the 2023 EU Corporate Sustainability Reporting Directive, both reflecting a growing demand for more ethical operations by MNCs (OHCHR, 2011; European Commision, 2023).

Economic growth in developing countries, like FDI, might not contribute to long-term development as long as the market structure is predominantly shaped by the interests of core countries. Because of the conditionality linked to international financial institutions like IMF and WTO, the idea that the free market as an independent and apolitical actor will lead to economic development in periphery countries does not withstand scrutiny. IMF's ability to withhold loans from developing countries until it is satisfied with the country's policy enables indirect forms of international governing through the markets (Pevehouse & Goldstein, 2021). This power was constructed by powerful states and supra-national agencies, essentially serving the interest of the developed core countries searching for new markets and cheap resources, just like in colonial times, without acknowledging that ex-colonies previous exclusion gives them a different starting foundation (Ayelazuno J. , 2014; Orvis & Drogus, 2021). Many of WTO's free-trade agreements benefit sectors where core countries have a comparative advantage, forcing developed countries to open home markets to foreign products whilst seeing their export shut out of foreign markets (Pevehouse & Goldstein, 2021). Thus, the neoliberal argument that FDI in developing host countries results in development by giving them further inclusion in the free market is not true (Rojas & Kindornay, 2014).

Conclusion

The findings of this paper strongly suggest that, in many cases, foreign direct investment is bad for development as it can lead to exploitation of the host countries in which the investments are made. This conclusion is particularly based on a persistent division between developed and developing, core and periphery countries. Pointing to the UN's emphasis on interdependence between economic, social, and environmental development, the paper presents arguments concerning all three. Various findings showcase the negative links between FDI and economic, social, and environmental spheres. Additional concerns related to MNCs investing in developing countries, including corruption, the resource curse, and supra-national agencies, are showcased, all underpinning the arguments later used to rebut a neoliberal

perspective, which tends to view the economic benefits of FDI positively. Essentially, as long as the structure of the free market acts as a continuation of the division between core and periphery countries presented in the world-systems theory, widespread sustained development will not be obtained by the promotion of FDI. Foreign direct investments will enable multinational corporations to exploit the host countries in which they operate as long the current system of the world market withstands.

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