The following pages contain a review of research that attempts to evaluate the impact of foreign investment dependence on a host economy. Read the review and makes notes in the boxes to the side of each paragraph about the author(s) and their contribution to the debate. The first two have been done as examples.

Then answer these questions.

1. What is a possible research question for the paper that contains this literature review?
2. What is the author’s hypothesis regarding foreign investment? What are his expectations?
3. How does he justify his hypothesis and expectations?

The Long Term Effects of Globalization on Income Inequality, Population Growth, and Economic Development

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## The Impact of Foreign Investment on Economic Development

Perhaps the most widely explored, and contested, of the relationships under study is the impact of foreign investment dependence on economic development (Bornschier, 1980; Bornschier & Chase-Dunn, 1985; Chase-Dunn, 1975; Dixon & Boswell, 1996; Firebaugh, 1992, 1996; Kentor, 1998; Soysa & Oneal, 1999). Researchers on both sides of this debate cite apparently "definitive" results supporting opposite conclusions. In this literature a key distinction is made between simple foreign investment (inflows of foreign capital) and what is referred to as foreign capital dependence. It is not foreign investment, per se, that has a negative impact on the host economy. Negative consequences arise when the host economy becomes dependent upon foreign capital for its development.

The question of whether foreign investment is a panacea or an albatross on a host economy was first addressed empirically by Christopher Chase-Dunn (1975), who found that his measure of foreign capital penetration (debits on investment income) had a negative effect on economic development. Bornschier, Chase-Dunn and Rubinson (1978) furthered Chase­Dunn's work by constructing a new measure of foreign capital penetration (PEN), a ratio of foreign capital stocks to investment flows, which also exhibited a negative effect on economic development. These findings were replicated by Bornschier (1980) and Bornschier and Chase­ Dunn (1985). It was variously argued in these works that foreign capital had a wide range of negative consequences. Foreign investment tended to be concentrated in a single product that dominated the host economy, resulting in commodity, trade and partner concentration. This concentration allowed the investing country to obtain and maintain a significant advantage over its dependent partner (Galtung, 1971). Further, profits from foreign investments tended to be repatriated, rather than reinvested in the host country (Bornschier, 1980), resulting in decapitalization and a lack of forward and backward economic linkages (Dixon & Boswell, 1996). Finally, it was argued that there were a host of long-term ancillary negative effects, the "negative externalities" that arose in the host country's social structure (Dixon & Boswell, 1996).

Firebaugh (1992, 1996) rejected Bornschier and Chase-Dunn's (1985) findings, and the subsequent findings of those who used their "PEN" measure of foreign capital penetration, as a statistical artifact, the well-known "denominator effect." Firebaugh argued that a correct analysis of these data indicated that foreign investment actually had a positive effect on economic development, albeit weaker than the effects of domestic investment. Dixon and Boswell (1996) reanalyzed Chase-Dunn's model with a new measure of foreign capital penetration (foreign investment stocks/GDP) that addressed Firebaugh's concerns, and were able to replicate the earlier negative findings.

Negative impact

* Chase-Dunn (1975)
* Bornschier, Chase-Dunn, & Rubinson (1978)
* Bornschier (1980)
* Bornschier & Chase-Dunn (1985)
* Galtung (1971)
* Dixon & Boswell (1996)

Introduction to the debate and clarification of the key terms.

Kentor (1998) examined the long-term lagged effects of foreign capital penetration on economic development. In a cross-national study of less developed countries between 1940 and 1990, Kentor found that two separate indicators of foreign capital penetration (debits on investment income and foreign investment stocks/GDP) had initial short-term positive effects on per capita GDP growth followed by a long-term (20+ year) negative effect. He argued that the short-term positive effects reflected the initial beneficial effects of capital flows into the host country, while the long- term negative effects were the consequences of trade distortions, decapitalization, lack of forward and backward linkages and the "negative externalities" discussed by Dixon and Boswell (1996).

Most recently, Soysa and Oneal (1999) reported that, in their reassessment of earlier models, foreign investment had a positive effect on economic growth between 1980 and 1990. In fact, according to Soysa and Oneal, foreign investment is actually two and one-half times as productive as domestic investment. However, Soysa and Oneal fail to address the question of the impact of long-term lagged effects described by Kentor (1998). In fact, their results would be consistent with Kentor's findings that foreign investment had a short-term positive effect followed by a long-negative one.

While a detailed discussion of Soysa and Oneal's work is beyond the scope of this paper, there is one aspect of this research that warrants mention. Their failure to examine these long-term effects reflects more than an empirical omission. It suggests a lack of understanding of the concept and mechanisms of structural dependence (Cardoso & Faletto, 1979). This term refers to the development and/or restructuring of the host economy to make it attractive to foreign investment, which affects a wide range of social political and economic structures.

These include laws permitting foreign ownership, convertibility and repatriation of currencies, favorable labor laws, lax environmental standards, and favorable tax treatments, among others. There is also an ideology that is legitimated concerning the value of foreign investment and incorporation into the global economy. These effects reproduce and exacerbate the negative effects of foreign investment far beyond, the commercial life of a given foreign investment.

How are we to interpret these conflicting analyses? In spite of those who dismiss the validity of negative findings of foreign capital penetration by simply referring to Firebaugh's (1992) critique of this body of work, an impartial review of the literature suggests otherwise. First, Firebaugh's critique refers only to Bornschier, Chase-Dunn and Rubinson's PEN mea­ sure of foreign capital penetration. Firebaugh does not address Chase-Dunn's (1975) earlier results using debits on investment income (subsequently supported by Kentor, 1998). Nor is Soysa and Oneal's myopic analysis of the short-term impact of foreign investment a valid rejection of the overall long-term negative effects found by Kentor (1998). In short, none of the critiques of these negative findings provide a basis for rejecting the basic tenet that dependence on foreign capital has negative consequences for the host economy.