

**WOLLO UNIVERSITY
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LAW OF INVESTMENT POWER POINT

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Target group 4th year Students

UNIT TWO: ECONOMIC THEORIES ON FOREIGN INVESTMENT

- Economic theories are used as justification to defend the interest of states in investment

- **4(four) economic theories of Foreign investment**

1. Classical economic theory on FI

- ✓ classical theorists argue that FI is wholly beneficial to the host economy
- 1. **Capital inflow**, Foreign investment makes available capital in the host state that flows from capital sending country and this capital then is used to promote the development of the economy of the host state.
- ✓ But other argues that the foreign investors will export the high profit obtained from the investment to their home state.

2. **Transfer of technology**

- FI transfers technology which is not available in the host state .
- FI help workers who are the citizens of the host state to learn **how to run the technology**
- They will use their technological knowledge and skill in a similar field in their country

Critics: Foreign investors may transfer technology that is out dated

- Use technology dangerous to environment
- It may be capital intensive, using such technology may be expensive



3. **Creation of employment:-** FI creates new employment opportunities.

- Accordingly, the unemployment problem that exists in a host state will be solved
- **Critics:** creating a new job opportunity should not be taken as a benefit only to the host state
- FI is highly beneficial from the creation of employment because labour is usually not expensive
- ✓ But, the workers will not be fully paid or the rate of wages is very low that is not commensurate with service they rendered.

4. **Transfer of managerial skill (skills in management of large projects)**

FI result in transfer of managerial skills from foreign investor to the local professions.

(but we can see that higher managerial position aren't given for local professionals)

5. **Building infrastructure and up grade infrastructures**

- Nevertheless a strong criticism has been made directly against this theory

2. The Dependency theory

- ✓ Dependency theory criticize the classical theory by redefining economic development and as per the dependency theory development is not wealth transfer to the host state, rather **it is the development of the people of the state as a whole**
- ✓ Again they said that foreign investment is a way for **developed countries to gain power in developing countries** and development in developing countries impossible since **their economy is dependent to the developed countries it means**, there cannot be development until the people as a whole are free from poverty and exploitation
- ✓ and development become the right of the people rather than that of the state (it is popular among Latin American economists).
- ✓ it influenced many nationalization of FDI in Peru, Jamaica and Chile.



3. The middle path

- ✓ Developed to make a balance between the **classical and dependency** theories
- ✓ In the period of globalization **free market economy** was accepted as a means to marshal economic development then **private economy** was considered essential for the development of a state economy
- ✓ Plus MNC is a threat to the sovereignty of developing state has changed and MNC on their part ceased to be instruments of the foreign policy of their home state and it was observed MNC formed alliance with developing state
- ✓ Nowadays, Foreign corporation in petroleum sector formed alliance with oil exporting state to the determinants of oil importing developed states



- ✓ A research by UN commission of TNCs contributed a lot to reduce the hostility towards MNC and there are different scholars debate on MNC in the 1980's the debate has had an influence on the laws used to control FI and the host state become aware of the fact that FI are play a vital role for the economic development of the host country, plus the host country regulate the FI and if there is any damage caused on FI the host state take the responsibility.

The research identified the positive effect of MNC

- Capital flow
- Transfer of technology
- Create new employment
- Create new opportunity for export income

- ✓ The study also identified the negative effect of MNC. This enable the host state to take regulatory measures to curb harmful practice.

-Defeating the Tax law of the host states

-Hazardous and disused technology and others

- ✓ It was possible to design codes of conduct for MNC and to avoid things that are identified as harmful to the economic development of developing states
- ✓ **N.B. Therefore the middle path theory propagates that mixing regulation and openness to FI should be the rule.**

4. The liberal consensus

- The liberal economic theory is based on premise that **free market yields maximum productivity**
- It was developed by **Adam smith and David Ricardo**
- They first challenged extensive state regulation of the economic activities is necessarily to promote the interest of a nation and in the 16th c. and 18th c .
- Liberalists argue that productivity of people is best achieved by unregulated market (they opposed restriction on national trade)(liberalism propagates for free market economy).

- ✓ In 1947, establishment of GATT heralded the coming into being of sustainable liberalism. In 19th C, industrialization bloomed. It was possible to produce **large capital surpluses**, and this in turn makes the capital available for investment.
- ✓ But consequently contemporary consensus emerged to make balance the market and argued that, in fact liberal economic theory could work but it is only if **the markets functioning** well , however markets fail in developing countries.
- ✓ State intervention is essential to correct serious market failure
- **Developed sates should also provide assistance, such as technical assistance with regard to the development of le gal institutions and economic assistance.**



○ THANK YOU!!!

