Foreign direct investment (FDI) is traditionally considered in development literature as instrumental for economic growth of countries, particularly the developing ones. It acts as a panacea for breaking out of the vicious circle of low savings–low income and facilitates import of capital goods and advanced technical knowhow. The worldwide globalization drive in leading to liberalization of foreign capital regimes has resulted in a spurt in the presence of multinational corporations. The growth rate in absorbing FDI has been so fast during the recent years that in 2012, the developing economies have attracted more FDI flows than the developed economies accounting for 52% of global FDI flows (UNCTAD 2013).

With FDI gaining so much prominence in the backdrop of liberalized investment policies, the welfare of developing economies ought to be significantly affected. Besides, these countries are subjected to phenomenal multi-dimensional impact on a host of other economic, social and environmental variables. The remarkable enthusiasm among developing countries to attract FDI, coupled with empirical results often contradicting the general contention of favourable effects calls for a close inspection into the diverse aspect and consequences of FDI on the host economy. A theoretical analysis of the different facets of FDI is indispensable, especially for formulation of appropriate policies for foreign capital.

In this book we attempt to delve into the complex interaction of FDI with different other factors. While FDI boosts up the efficiency of domestic producers, it impinges on the labour market affecting wages, unemployment levels, and wage inequalities on the basis of skill and gender; it also has important implications on the socio-economic issues like child labour, agricultural disputes over special economic zones (SEZ) and human capital formation through externalities. The empirical evidences with regard to most of the effects of FDI are highly mixed and reflect the fact that there exist a number of mechanisms that interact with each other producing opposing results. We try to provide the theoretical underpinnings behind
the inherent contradictions and show that the final outcome depends on a number of
country-specific factors like endowments of other production, technological, and
institutional factors.

We give an outline of the established doctrines relating to FDI and elucidate on
the newer ones to trace the nature and direction of desirable policy parameters that
may be relevant in the present scenario. We incorporate the effects of FDI within the
traditional Heckscher-Ohlin model and introduce different kinds of distortions that
developing countries are rampanty plagued with, like imperfections in the factor
markets and product market and presence of non-traded goods. We consider the
cases where FDI enters not only the export and import-competing sectors but also
the intermediate and services sectors. Other characteristics typical in developing
countries like labour market segmentation, with the existence of skilled/unskilled
labour, male/female labour and child labour have also been taken into account. Thus,
although not exhaustive, we have tried to integrate FDI within the important existing
economic systems to find out its much-debated role in developing economies.

Although a number of theoretical articles relating to FDI have been published
in different journals, very few books address all the issues and dimensions related
to FDI comprehensively in a simple theoretical and formal framework, as we do
here. The major part of the book is based on Chaudhuri’s own, and sometimes
collaborative, research, carried out in Kolkata, India and published in different
international journals over the last decade and a half. Throughout the book we have
used the simple ‘hat calculus’ developed and popularized by R.W. Jones in his two
seminal articles, Jones (1965, 1971). We felt the necessity to discuss in detail on
extensions of the simple two-sector general equilibrium models, inclusion of non-
traded goods and factor market imperfections and the techniques of measuring social
welfare in a small open economy. All these give a future economist a thorough idea
how simple general equilibrium models can readily be used to analyze different
complex problems pertaining to the developing world and to suggest remedial
measures based on findings of the theoretical models. The contents of the book can
be a part of a course on trade and development at the postgraduate level. These can as
well be a small part of a course on labour economics in universities in the developing
world. Although the book is primarily intended towards postgraduate students and
researchers who are pursuing theoretical research on trade and development, it is
also aimed at suggesting alternative policies to policymakers in the developing
nations for application to development projects.

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Kolkata, India
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Sarbajit Chaudhuri

Ujjaini Mukhopadhyay

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